In the
Supreme Court of the United States

OCTOBER TERM A. D. 1940.

NO. 539 - 543

STATE OF MINNESOTA, Petitioner,

vs.

DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY, and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO._____

STATE OF MINNESOTA, Petitioner,

vs.

THE DULUTH AND IRON RANGE RAIL ROAD COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO._____

STATE OF MINNESOTA, Petitioner,

vs.

SPIRIT LAKE TRANSFER RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO._____

STATE OF MINNESOTA, Petitioner,

vs.

OLIVER IRON MINING COMPANY, Respondent.

NO._____

STATE OF MINNESOTA, Petitioner,

vs.

PROCTOR WATER & LIGHT COMPANY, Respondent.

PETITION OF WRITS OF CERTIORARI TO THE SUPREME COURT OF MINNESOTA AND BRIEF IN SUPPORT THEREOF

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Court Printing Company, 322 So. 4th St., Minneapolis

SUBJECT INDEX.

TABLE OF CASES CITED.

TABLE OF STATUTES CITED.

TABLE OF OTHER REFERENCES.

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PETITION FOR WRITS OF CERTIORARI TO THE SUPREME COURT OF MINNESOTA.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States.

Your petitioner, the State of Minnesota, by its counsel, respectfully shows:

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The legislature of Minnesota enacted Laws of 1933, Chapter 405[1] imposing on individuals and corporations "income taxes and franchise or privilege taxes measured by income."

The act has been sustained by the Minnesota Supreme Court against certain claims that it violated the equal protection and due process clauses of the Fourteenth Amendment to the United States Constitution and the uniformity clause of the Minnesota Constitution.[2]

The State of Minnesota brought five separate suits against the corporations above named for taxes under this act for the year 1933. The five actions were consolidated for trial in the state district court.

In the cases of the railroad company defendants it was asserted by defendants in their pleadings and in the state district and supreme courts that the imposition of the tax "would deprive this defendant, and said other railroad corporations, of their property without due process of law and deny to them the equal protection of the laws contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States" and contrary to provisions of the Minnesota Constitution. These several contentions were denied by plaintiff.

The Minnesota Tax Commission assessed a tax against

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[1]This act in its original and amended forms is found in Volume 3, Cumulative Supplements to Mason's Minnesota Statutes, 1927, sections numbered 2394-1 et seq.

[2]Reed v. Bjornson, 191 Minnesota Reports 254, 253 Northwestern Reports 102; Thompson-Parker Holding Company v. Bjornson, 191 Minnesota 271, 253 Northwestern 110.

each corporation separately. The defendants in each case asserted in their pleadings and in the district and state supreme courts that they were entitled to have their taxes calculated on a consolidated basis including in such consolidation the net incomes or net deficits of 75 other subsidiaries of the United States Steel Corporation. Section 32 (c) of the Act[3] provided that under certain circumstances of corporate affiliation and control "the (Tax) Commission may impose a tax as though the combined entire taxable net income was that of one corporation". (Emphasis supplied.) Defendants asserted the claim that this provision was mandatory and that the failure of the Tax Commission to impose a tax on a consolidated basis was "an attempted exercise of a legislative function which has not been and cannot be delegated to said Commission." The statutory provision in its permissive form was asserted by defendants, in the district court and in the Minnesota Supreme Court, to "deny to this defendant and its said affiliated corporations the equal protection of the laws and would deprive them of their property without due process of law contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States." The statutory provision was alleged by defendants to violate the uniformity clause of the Minnesota Constitution, Art. 9, Sec. 1, as well as Art. 3, prohibiting delegation of legislative powers to the Tax Commission. These contentions were denied by plaintiff.

The trial court upheld the claim of defendants that the railroad corporations were not taxable upon any part of their income whether "railroad income" or "non-railroad income." It held with the state that defendants were not entitled to be taxed on a consolidated

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[3]Vol. 3, Cumulative Supplements to Mason's Minnesota Statutes, 1927 Section 2394-32 (c).

basis and that the non-railroad defendants were subject to the tax.

The state appealed to the Minnesota Supreme Court in the railroad cases and the non-railroad defendants appealed in the other two cases. The three railroad cases were argued together December 7, 1939, and the other two cases were argued together the following day, December 8, 1939. Two opinions in the five cases were filed by the Minnesota Supreme Court December 29, 1939. Upon petitions for reargument one further opinion was filed in all five cases April 26, 1940.

These opinions are reported as **State v. Duluth, Missabe and Northern Railway Company,** 207 Minn. 618, 292 N. W. 401, **State v. Oliver Iron Mining Company,** 207 Minn. 630, 292 N. W. 407, and **State v. Duluth, Missabe and Northern Railway Company,** 207 Minn. 637, 292 N. W. 411.

The state supreme court held that "railroad income" was not taxable but that "non-railroad income" was taxable.

The state supreme court held that defendants were entitled to a consolidated basis of taxation; that to construe Section 32 (c) as permissive would be violative of the Fourteenth Amendment; and that failure to construe it as mandatory would be violative of the Fourteenth Amendment. We expect to show that the non-federal grounds given for the construction were not independent nor adequate to sustain the judgments on this point.

The statutory measure of the Minnesota Income and Franchise Tax Act of 1933 is net income. Net income consists of gross income less certain deductions.

In computing net income the Minnesota Tax Commission included in gross income of defendant Duluth Missabe and Northern Railway Company an amount of

$7,774,804.19 received by it from the United States in 1933. Defendants asserted in their pleadings and in the district and supreme courts of the state that this amount of $7,774,804.19 was not properly includable for computation in the tax and that said moneys received from the United States did not constitute income of this defendant taxable under the Minnesota Income and Franchise Tax Act.

Pursuant to the Transportation Act, Act of Congress of February 28, 1920, 41 Stat. 488, the defendant Duluth, Missabe and Northern Railway Company had transferred and paid to the United States for the years 1920, 1922, 1923, 1925, 1926, 1928 and 1929, the aggregate sum of $5,808,256.61. At the times of transfer and payment to the United States and thereafter defendant had no title legal or equitable, to these amounts. These amounts belonged to the United States.[4]

The defendant Duluth, Missabe and Northern Railway Company received said amount of $7,774,804.19 from the United States pursuant to Act of Congress of June 16, 1933, 48 Stat. 220. This act liquidated and distributed the moneys belonging to the United States held in the general railroad contingent fund accumulated pursuant to the said Transportation Act of 1920. Under the provisions of this Act the entire amount of $7,774,804.19 received by the defendant from the United States was expressly made subject to the payment of federal income taxes for the year 1933.

The Act of Congress of 1933 created this income as income in the hands of defendant Duluth, Missabe and Northern Railway Company. Prior thereto it was property of the United States. Without the Act of Congress there would have been no such income of defendant.

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[4]Dayton-Goose Creek R. Co. v. U. S., 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388.

This sum of $7,774,804.19 is "non-railroad income" under the differentiation of "railroad" and "non-railroad income" fixed and established by the state supreme court under the Minnesota Income and Franchise Tax Act. It is the contention of petitioner that the Minnesota Supreme Court erroneously construed the Acts of Congress of February 28, 1920 and June 16, 1933, and failed to give effect to the decision of this court in the case of **Dayton-Goose Creek R. Co. v. U. S. supra,** and as a result thereof placed said amount of $7,774,804.19 in the category of "railroad income" instead of in the category of "non-railroad income."

The inclusion or exclusion of this amount in the measure of the tax makes a total difference of $388,740.21. This item constituted a substantial part of plaintiff's cause of action against Duluth, Missabe and Northern Railway Company.

It is the contention of petitioner that it is entitled to a correct construction of said Acts of Congress and that it is entitled to have the decision of this court in the case of **Dayton-Goose Creek R. Co. v. U. S., supra,** applied to said Acts of Congress.

The misconstruction by the state supreme court of the said acts of Congress and the misapplication of the statutory definition as construed by the court, destroyed not only an essential element of plaintiff's cause of action against the Duluth, Missabe and Northern Railway Company, but also, as we shall hereinafter more particularly point out, materially and substantially affected plaintiff's causes of action against the defendants in the other cases. This error in its application is common to all defendants in all of the above cases.

The state supreme court having held that defendants and the 75 other subsidiaries of the United States Steel Corporation were entitled to a consolidated basis of taxation, the necessary effect of the removal of this item of $7,774,804.19 from the total of gross income was to reduce the total combined income to a point where, with other deductions made by the supreme court, the entire tax was wiped out against all the corporations.

The state also included in the measure of the franchise tax sought to be collected from the defendants interest from federal securities which in the case of the Duluth, Missabe and Northern Railway Company amounted to $150,044.12 and in the case of The Duluth and Iron Range Railroad Company $214,066.12. These defendants claim that this income could not be included in the measure of their tax because it was immune from taxation under the federal constitution, Acts of Congress, and the Minnesota statute. The state on the other hand contended that this income was properly included in the measure of defendants corporate franchise tax under the provisions of Section 12 of said Act which included in gross income income from all securities of every description whatsoever with the **sole exception** of securities of the State of Minnesota and its local governmental subdivisions.

The Minnesota Supreme Court decided in favor of defendants on this point. The reason given by the court for its decision was that the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise tax constituted an "unfriendly discrimination" against the United States in favor of local securities in "substantial competition" with federal securities and was therefore unconstitutional.

There was also a non-federal ground given by the court for its decision. However, as demonstrated in

the jurisdictional statement herein, page 36 infra, this was the result of the court having completely overlooked subdivision (*l*) of Section 12 of the Minnesota statute which expressly included interest from federal securities in the measure of the tax. The circumstances connected with the overlooking of this subdivision (*l*) by the court are fully set forth in the jurisdictional statement, Section C.

The date of the judgments sought to be reviewed in these cases is June 13, 1940. The mandates to the trial court have been stayed pending proposed review by this court.

The time for making application for a writ of certiorari in each of the above entitled cases was on September 9, 1940 extended for a period of thirty days from September 12, 1940, by order of Mr. Justice Black. On October 7, 1940, a further extension for a period of twenty days from October 12, 1940, was made by order of Mr. Justice Reed.

The statutory provisions believed to sustain the jurisdiction of the Supreme Court of the United States to review by writ of certiorari the judgments of the Supreme Court of Minnesota is Section 237 (b) of the Judicial Code, as amended, United States Code Annotated, Title 28, Section 344 (b), which provides:

> "It shall be competent for the Supreme Court, by certiorari, to require that there be certified to it for review and determination, with the same power and authority and with like effect as if brought up by writ of error, any cause wherein final judgment or decree has been rendered or passed by the highest court of a State in which a decision could be had * * * where is drawn in question the validity of a statute of any State on the ground of its being repugnant to the Constitution, * * * or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed by either party under the Constitution, or any * * * statute of, * * * or authority exercised under the

United States; and the power to review under this paragraph may be exercised as well where the Federal claim is sustained as where it is denied. * * *"

It is the contention of petitioner that the above entitled actions, and each of them, involve, and there is drawn in question in the above entitled actions, and each of them, the rights specially set up and claimed by petitioner under the Constitution of the United States and amendments thereof, and under those certain statutes of the United States, and each of them, to-wit, Act of Congress of February 28, 1920, 41 Stat. 488, Chapter 91, and especially Section 422 thereof, Title 49, United States Code Annotated, Section 15 a, and Act of Congress of June 16, 1933, 48 Stat. 220, Chapter 91, and especially Title II, Section 206, thereof, Title 49, United States Code Annotated, Section 15 b, and under the authority exercised thereunder.

There is further drawn in question in the above entitled actions, and each of them, the validity of said statute of the State of Minnesota, namely, Chapter 405, Laws of Minnesota 1933, and especially Section 32 and subsection 32 (c) thereof in the form in which the legislature enacted said chapter and section on the ground of its being repugnant to the Constitution of the United States and the amendments thereof, especially the Fourteenth Amendment, Section 1, and the due process and equal protection clauses thereof.

There is also drawn in question in the above-entitled actions and each of them the validity of Section 12 of said statute, Chapter 405, on the ground of its being repugnant to the immunity of federal securities from taxation by the states under the Constitution of the United States.

Relevant excerpts from Chapter 405, Laws Minnesota 1933 are set forth in the Appendix hereto as Exhibit A.

The date upon which the application for writ of certiorari herein is presented is November 1, 1940.

STATEMENT PARTICULARLY DISCLOSING THE BASIS UPON WHICH IT IS CONTENDED THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENTS IN QUESTION.

For the convenience of the court we have divided the jurisdictional statement into three parts: Section A, relating to payments to defendant Duluth, Missabe and Northern Railway Company by the United States under Act of Congress of June 16, 1933; Section B, relating to taxation of affiliated corporations on a combined basis; and Section C, relating to inclusion of interest from federal securities in the measure of the Minnesota Corporate Franchise Tax Act.

Section A. Payments to defendant Duluth, Missabe and Northern Railway Company by the United States under Act of Congress of June 16, 1933.

There is drawn in question in the above entitled actions, and each of them, the rights specially set up and claimed by petitioner under the Constitution of the United States and amendments thereof, and under certain acts of Congress, namely, Act of Congress of February 28, 1920, 41 Stat. 488, and Act of Congress of June 16, 1933, 48 Stat. 220, and authority exercised under the United States. Judicial Code, as amended, Section 237 (b), quoted above.

Relevant excerpts of these Acts of Congress are set forth in the Appendix as Exhibits B and C, respectively.

The plaintiff's cause of action against each defend-

ant is measured by the net income of defendant in each case. The net income is governed by the amount of gross income because net income is gross income less certain statutory deductions. Thus the amount of gross income has a determining effect upon the amount of the tax which is 5% of the net income less certain specific statutory deductions.

In the case against the defendant Duluth, Missabe and Northern Railway Company, the moneys received by it from the United States in 1933 amounting to $7,774,804.19 directly affect plaintiff's cause of action against that company and determine its cause of action to the extent of $388,740.21. The amount of gross income is an essential element of plaintiff's cause of action.

This portion of defendant's gross income and this element of plaintiff's cause of action was created by, and the nature of the element determined by, the Acts of Congress above referred to.

The other defendants except Duluth, Missabe and Iron Range Railway Company and Spirit Lake Transfer Railway Company are affected by the inclusion or exclusion of this amount in connection with defendants' claim of right to be taxed on a consolidated basis. This relationship will be developed in Section B hereof.

The defendant Duluth, Missabe and Iron Range Railway Company is affected as a successor in interest of the other three railroad corporations. The allocation of income on a combined basis is or may be affected by Spirit Lake Transfer Railway Company. All are Minnesota corporations.

Under the Minnesota Income and Franchise Tax Act, Chapter 405, Laws of Minnesota 1933, "non-railroad income", i. e., "income derived from the exercise of the corporate franchise without the scope of railroad owner-

ship or operation" is includable in the measure of the tax.

It was and is the contention of petitioner that the said $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States was non-railroad income under the above definition of non-railroad income fixed and established by the Minnesota Income and Franchise Tax Act as construed by the state supreme court.

This contention of petitioner is discussed in the annexed Brief, pages 50 et seq., and for the sake of brevity our argument in that connection will not be repeated here.

At page 51, et seq., we discuss "differentiation of income under the Minnesota Income and Franchise Tax Act as construed by the state supreme court."

Under this differentiation income derived from the exercise of the corporate franchise **without** the scope of railroad ownership or operation is non-railroad income. See page 51, et seq., of the accompanying Brief.

The corporate franchise was not exercised for railroad purposes in the acquisition of the $7,774,804.19 from the United States. Page 53, et seq.

The state supreme court determined that all of the money received by the Duluth, Missabe and Northern Railway Company from the United States was railroad income.

The state contends that this was an erroneous construction and conclusion and involved an erroneous interpretation of the Acts of Congress of June 16, 1933, and of February 28, 1920, respectively, 48 Stat. 220 and 41 Stat. 488, and that such construction and conclusion involved a failure of the state supreme court to follow the decision of the United States Supreme Court construing said Act of Congress of 1920 in **Dayton-Goose Creek R. Co. v. U. S., supra.**

It is the contention of the petitioner that if the state supreme court construes an act of Congress expressly or by necessary intendment, then it must construe it properly and a failure to construe it properly raises a federal question. It is the contention of the state that the above-mentioned Acts of Congress are necessarily involved in defining and determining plaintiff's causes of action.

It is the further contention of petitioner that the state supreme court expressly or by necessary intendment passed upon petitioner's federal claims relating to the Acts of Congress above referred to. As we understand the rule of this court, if the state supreme court expressly passed upon petitioner's claims, it is immaterial how or when the federal claims were raised in the state supreme court.

However, defendants at all stages of the litigation, in the pleadings and at the trial and in the state supreme court, asserted the federal grounds alleged to be involved, namely, that taxation of the railroad corporations and their income, including the taxation of the $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States in 1933 pursuant to the Acts of Congress of 1933 and 1920, violated their rights under the Constitution of the United States and under said Acts of Congress.

At page 293 Record, Case No. 32125 in paragraph 10 of Answer (Substituted) of the Duluth, Missabe and Northern Railway Company defendant alleged that the said $7,774,804.19 (amount itemized: $5,808.256.61; $1,817,163.52; $149,384.06) "* * * represent moneys received by the taxpayer from the United States Government under the provisions of the Acts of Congress of June 16, 1933, being chapter 91, Title II, section 206, 48 Stat. 220, that such moneys do not constitute income

of this defendant taxable under the Minnesota State Income Tax Act among other reasons because they constitute a gift from the United States Government, an instrumentality of the United States Government and/or income earned by the taxpayer in previous years."

In paragraph 12 of said Answer (Substituted) page 293 Record, Case No. 32125 defendant alleged "* * * that prior to the year 1933 it paid to the Interstate Commerce Commission, under the provisions of the so-called Recapture Clause of the Transportation Act of 1920, 41 Stat. 489, the aggregate sum of $5,808,256.81 * * *". This amount is the same sum referred to in paragraph 10 as part of the $7,774,804.19 received by defendant from the United States in 1933.

Defendants' assertion of federal rights were contentions on their part with respect to the essential elements of plaintiff's causes of action.[5] Plaintiff's causes of action did not change. The federal elements existed from the beginning.

Plaintiff in Exhibit 2 attached to its Statement (Complaint) Record page 35, Case No. 32125, specified the $5,808,256.61 principal of the recapture fund above referred to and the $1,817,163.52 of the accretions referred to, the remainder of the accretions amounting to $149,384.06 having been included in defendant's tax return. See Record page 293, paragraph 10 supra where defendant refers to this amount as having been erroneously reported as taxable income. And see Exhibit S-1 (b) Record page 87 where this amount is referred to as "accretions to recapture fund included as income in return and now claimed to be non-taxable by tax payer $149,384.06."

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[5]Cf. Jones National Bank v. Yates, 240 U. S. 541, 36 S. Ct. 429, at pages 432, 433, 60 L. ed. 788.

Although it is petitioner's contention as asserted above that the state supreme court expressly passed upon its federal claims relating to the Acts of Congress of 1933 and 1920 and the authority exercised under the United States by virtue of said Acts, the federal questions relating to the moneys paid by the United States and the construction and application of the Acts of Congress were duly raised and specially set up in plaintiff's petitions for rehearing and reargument in these cases in the state supreme court prior to the decision of April 26, 1940, 207 Minn. 637, 292 N. W. 411, and long prior to the judgments herein. In its Reply and Supplement to State's Petitions for Rehearing and Reargument duly filed in a section entitled, "This Court by Its Decisions Relating to the Principal Amount of Recapture Fund has Misconstrued and Misinterpreted the Acts of Congress of 1920 and 1933, 41 Stat. 488 and 48 Stat. 220, and the Construction of the 1920 Act by the United States Supreme Court and Thereby Denied to Plaintiff Rights under the Constitution of the United States and under said Acts of Congress" and elsewhere in that document filed March 16, 1940, pursuant to permission of the court these federal questions were discussed and specially set up both as to the so-called principal of the recapture fund amounting to $5,808,256.61 and as to the so-called accretions to the fund amounting to $1,966,547.58.

This, as above stated, was all prior to any judgments in the state supreme court. Plaintiff's supplement to its rehearing petitions served on defendants March 15, 1940, filed March 16, 1940, was answered by defendants March 21, 1940, in an Answer in which defendants did not controvert plaintiff's arguments on the federal questions but said at page 9 thereof: "Other points made by the state are simply restatements of argu-

ments already made and have been answered by our earlier briefs."

It was following plaintiff's petitions for rehearing and reargument and the said supplement thereto that the state supreme court's decision of April 26, 1940, was rendered, 207 Minn. 637 and 292 N. W. 411. The judgments in the state supreme court were not rendered until June 13, 1940.

The court in its decision on the Petitions for Rehearing and Reargument, April 26, 1940, reiterated its position on the recapture funds, principal as well as accretions, and at 207 Minn., pages 639, 640, 292 N. W., at pages 412, 413, paid special attention to the accretions amounting to $1,966,547.58.

In this decision of April 26, 1940, the court further, 207 Minn., at page 639, 292 N. W., at page 412, construed and defined the Minnesota Income and Franchise Tax Act of 1933 making it clear that the distinction between railroad and non-railroad income under that Act lay "between income derived from the exercise of the franchise within the scope of railroad ownership or operation and that from its exercise without such scope." This definition, as we point out in more detail later in our Brief, placed the $7,774,804.19 payment from the United States in the category of non-railroad income.

Petitioner contends not only that its federal claims relating to the Acts of Congress of 1920 and 1933 were expressly passed upon in the court's decisions of December 29, 1939, but also that these claims were expressly passed upon by the court in its decision of April 26, 1940, following the Petitions for Rehearing and Supplement thereto.

The state supreme court in its decision of December 29, 1939, as we more fully point out under Points I and II of our Brief failed to give due effect to the Act of Con-

gress of 1933, failed to properly construe said Act, failed to give due effect to the Act of Congress of 1920, failed to properly construe said Act, and failed to give due effect to the decision of the United States Supreme Court in the case of **Dayton-Goose Creek R. Co. v. United States, supra.** The result of this misconstruction was that the payment of $7,774,804.19 made by the United States to defendant pursuant to the Act of 1933 out of moneys belonging to the United States accumulated in connection with the Act of 1920 were treated as if they were railroad earnings received by the Duluth, Missabe and Northern Railway Company in the ordinary course of its transportation business. We especially call attention to that part of the decision of December 29, 1939, 207 Minn. 618, at pages 624, 625, 292 N. W. 401, at page 405, quoted at pages 51, 52 of Brief, infra.

The rights of petitioner specially set up passed on by the state supreme court and denied to petitioner by the state supreme court include the following:

Plaintiff was entitled to have all non-railroad income included as part of its cause of action against the Duluth, Missabe and Northern Railway Company, against its successor and against the other defendants in the other four cases.

A correct interpretation or application of the Acts of Congress would result in placing the payments made by the United States in the non-railroad category. **Plaintiff was entitled to a correct construction and application of the Acts of Congress. A correct construction and application of the Acts of Congress would have avoided the denial of plaintiff's rights in these respects.** A correct construction and application of the Acts of Congress would have resulted in recognition of the complete cut-off and severance of the title and interest of the Duluth Missabe and Northern Railway

Company in and to the funds in the general railroad contingent fund, and would have resulted in the recognition of the $7,774,804.19 as non-railroad income. It will be observed that the money was treated as income but it was treated as the wrong kind of income and the applicable definitions and principles governing the differentiation of the income were ignored.

Plaintiff was entitled under the Act of Congress of 1920 to have the state supreme court take account of that act and of the decision of this court construing it in the Dayton-Goose Creek case, and plaintiff was entitled to have the state court recognize the complete cut-off and severance of the payments made by defendant, Duluth, Missabe and Northern, to the United States in the years 1922 to 1929 amounting to $5,808,256.61. Had the court done so it would have found it impossible to say, as above quoted, 207 Minn. at page 625, 292 N. W. at page 405, that "the repayment amounts to nothing more than the return to defendants of their own railroad earnings. The restoration reinstated the earnings in their original status."[6] It was obviously impossible to thus unscramble the transactions from 1920 to 1929. Or if it had said so, it could have made this statement only in a figurative sense and without attaching thereto any meaning which would have a bearing on the proper description of the funds with reference to the proper income category as laid down in its established definition and principle of differentiation. The state supreme court's fixed and established definition and principle of differentiation was definitively stated by the state supreme court in 207 Minnesota, at page 639, 292 Northwestern, at page 412, supra, as "the distinction (between railroad and non-railroad income) should lie

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[6]207 Minn. 618, 625, 292 N. W. 401, 405.

between **Income derived from the exercise of the (corporate) franchise within the scope of railroad ownership or operation and that from its exercise without such scope.**" (Emphasis and parentheses supplied.)

Plaintiff was entitled under the Act of Congress of 1933 to have the state supreme court hold and recognize that the receipt by defendant of $7,774,804.19 from the United States in 1933 was solely as a result of the Act of Congress and that defendant owed the receipt of the money solely and entirely to the distribution made by Congress and not at all to any exercise of the corporate franchise by defendant for railroad purposes.

Plaintiff was further entitled to have the supreme court hold that the Act of 1933 was confirmatory of the complete cut-off and severance of defendant's title and interest, legal and equitable, in the sum of $5,808,256.61. Plaintiff was further entitled to have the state supreme court hold that the accretions amounting to $1,966,-547.58, had not even passed through the hands of defendant until the distribution by Congress in 1933.

Recognition of these considerations would have prevented the conclusion above quoted that "the restoration reinstated the earnings in their original status."

In the case of **Jones National Bank v. Yates, supra,** 240 U. S. 541, 36 S. Ct. 429, at page 433, 60 L. ed. 788, this court said with respect to defining the liability of national bank directors that if the plaintiffs' cause of action required the application of the federal statute in defining the liability with respect to the acts alleged and proved, the plaintiffs were entitled to the correct application of the federal statute.

Likewise in the instant cases, if the state's cause of action against Duluth, Missabe and Northern Railway Company required the application of the Acts of Con-

gress in defining the liability of defendant, the state was entitled to their correct application.

The correct construction and application of the Acts of Congress vitally affected each of plaintiff's causes of action.

Denial of such construction and application deprived plaintiff of valuable rights under the United States Constitution, under said Acts of Congress and under the authority of the United States.

We call attention to the fact that we do not have here a case where the state legislature undertook to characterize as "railroad income" certain income which was not such in fact.[7]

The **definition** of non-railroad income when applied to the **fact** of income leaves no room for doubt of the result, namely, that the $7,774,804.19 received by defendant, Duluth, Missabe and Northern is non-railroad income under the Minnesota statute.

The **definition** cannot be misconstrued or misapplied without violating plaintiff's rights under the Acts of Congress. Plaintiff is entitled to have the definition applied like any other litigant.

The **facts** cannot be ignored or misconstrued without violating plaintiff's rights under the Acts of Congress. If the method of treatment employed by the state supreme court be held to result in an adequate non-federal ground, then the construction and application of federal statutes may be entirely circumvented.

There is a good deal in the state supreme court's opinions, both in the first opinion in the railroad cases and in the last opinion of April 26, 1940, which furnishes grounds for the view that that court ignored the facts of the income. The court said: "The restoration rein-

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[7]Cf. Tyler v. United States, 281 U. S. 497, 50 S. Ct. 356, 74 L. ed. 991, 69 A. L. R. 758.

stated the earnings in their original status." Such unscrambling could, of course, not take place and at most the expression might serve a rhetorical purpose. This treatment simply ignored the facts and applied the definition of non-railroad income as if the income had been ordinary railroad income. If the facts were ignored a federal question is involved, because the facts of the income were dependent upon the Acts of Congress. Their very nature were created by Congress.

If, however, the state court recognized that the money was income received from the United States but treated it as not different, for example, from money received from the United States for transportation of the mails, then the facts remained distorted because this payment was different from payment for transportation of the mails and a federal question was involved. To treat it as the same would ignore the Acts of Congress of 1920 and 1933, as well as the decision of this court interpreting the former act.

Conceivably the state court might have recognized and considered the true nature of the facts of the income and might have taken cognizance of the Acts of Congress but misconstrued the Acts of Congress or misapplied them. In any event a federal question remained.

The United States Supreme Court is not concluded by the findings of fact or by a mixed finding of law and fact made by the state court. **Great Northern Ry. Co. v. Washington,** 57 S. Ct. 397, 300 U. S. 154, 81 L. Ed. 573. This court, at 57 Supreme Court, page 403, 300 U. S. page 166, quoting from the case of **Norris v. Alabama,** 55 S. Ct. 579, 294 U. S. 587, 79 L. ed. 1074, which involved a question of fact, said:

> "That the question is one of fact does not relieve us of the duty to determine whether in truth a federal right has been denied. When a federal right has been specially set up and claimed in a state

court, it is our province to inquire not merely whether it was denied in express terms but also whether it was denied in substance and effect. If this requires an examination of evidence, that examination must be made. Otherwise, review by this Court would fail of its purpose in safeguarding constitutional rights. Thus, whenever a conclusion of law of a state court as to a federal right and findings of fact are so intermingled that the latter control the former, it is incumbent upon us to analyze the facts in order that the appropriate enforcement of the federal right may be assured."

The following additional fact cases were cited in the case of **Great Northern Railway Company v. Washington, supra:**

Beidler v. South Carolina Tax Commission, 51 S. Ct. 54, 282 U. S. 1, 75 L. ed. 131;

Johnson Oil Company v. Oklahoma, 54 S. Ct. 152, 290 U. S. 158, 78 L. ed. 238.

This court further said, 57 S. Ct. at page 404, 300 U. S. at page 167:

"Citation of authority for the same principle might be multiplied indefinitely."

If the view be taken that the state supreme court merely declined to pass on the facts to which the statutory principle was to be applied, or declined to pass on the Acts of Congress involved, the federal question would not thus be avoided.

"* * * But the Constitution, which guarantees rights and immunities to the citizen, likewise insures to him the privilege of having those rights and immunities judicially declared and protected when such judicial action is properly invoked. Even though the claimed constitutional protection be denied on nonfederal grounds, it is the province of this Court to inquire whether the decision of the state court rests upon a fair or substantial basis. If un-

substantial, constitutional obligations may not be thus avoided."

Lawrence v. State Tax Commission of Mississippi, 52 S. Ct. 556, 558, 286 U. S. 276, 282, 76 L. ed. 1102, 87 A. L. R. 374.

"Where a federal right is concerned we are not bound by the characterization given to a state tax by state courts or Legislatures, or relieved by it from the duty of considering the real nature of the tax and its effect upon the federal right asserted."

Carpenter v. Shaw, 50 S. Ct. 121, 123 280 U. S. 363, 7, 8, 74 L. ed. 478.

In the case of **Ancient Egyptian Arabic Order of Nobles of Mystic Shrine v. Michaux**, 49 S. Ct. 485, 279 U. S. 737, 73 L. ed. 931, a Texas court held that facts showed no laches as pleaded by defendant and in this court such ruling was held not to avoid the federal question. This court reviewed the evidence and held that laches occurred and reversed the state court.

A similar case was **Creswill v. Grand Lodge Knights of Pythias of Georgia**, 32 S. Ct. 822, 225 U. S. 246, 56 L. ed. 1074. In that case a jury had a Georgia court held that no acquiescence or laches existed in fact. This court reviewed the evidence and came to a conclusion on the facts contrary to that of the Georgia court and reversed the judgment.

We believe there can be no question of the nature of the facts to which the definition of the Minnesota statute is to be applied. However, if any such question be deemed to exist, then there are ample precedents of this court for inquiring into the facts to determine if a federal question is involved and to determine if an adequate non-federal ground exists.

The principal, if not the only, supposed non-federal ground given by the state court in support of its deci-

sion in this connection is that "the restoration reinstated the earnings in their original status." 207 Minn. at page 625, 292 N. W. at page 405, supra. As stated in the record page 74, they were earnings as follows:

"Date of Payment	For the Year	Amount of Payment
	1920	$620,000.00
	1922	89,000.00
	1923	2,142,000.00
May 5, 1924		$2,851,000.00
April 27, 1926	1925	545,892.85
April 25, 1927	1926	366,777.60
April 26, 1929	1928	364,780.35
April 29, 1930	1929	1,679,805.81
Total		$5,808,256.61"

We repeat that this is not a case where the state legislature undertook to characterize as "railroad income" certain income which was not such in fact. In the absence of any such characterization petitioner is entitled to have the statutory definition of non-railroad income applied to the facts as they exist.

We submit that this supposed non-federal ground is as wholly inadequate as was the state court's holding of voluntary payment as a non-federal ground in **Ward v. County Comrs of Love County,** 40 S. Ct. 419, 253 U. S. 17, 66 L. ed. 751, or the state court's holding of no laches in the Creswill case, supra.

In the Ward case just cited the state supreme court misconstrued petitioner's right under a real property exemption provided under Indian treaty stipulations. This court said at 40 S. Ct., page 421, 253 U. S., at page 22,

> "The right to the exemption was a federal right, and was specially set up and claimed as such in the petition. Whether the right was denied, or not given due recognition, by the Supreme Court is a question

> as to which the claimants were entitled to invoke our judgment, and this they have done in the appropriate way. It therefore is within our province to inquire not only whether the right was denied in express terms, but also whether it was denied in substance and effect, as by putting forward nonfederal grounds of decision that were without any fair or substantial support." (cases cited) "Of course, if nonfederal grounds, plainly untenable, may be thus put forward successfully, our power to review easily may be avoided". (Case cited)

In **Davis v. Wechsler,** 44 S. Ct. 13, 263 U. S. 22, 68 L. ed. 143 the federal right involved was the right of petitioner to venue as determined by a regulation of the director general of railroads under an act of Congress. The state court treated the regulation as having been waived by appearance. But this court said that the effect of the act of Congress and of the general order of the director general could not thus be avoided. This court said, 44 S. Ct. 14, 263 U. S. 24:

> "If the constitution and laws of the United States are to be enforced this court cannot accept as final the decision of the state tribunal as to what are the facts alleged to give rise to the right or to bar the assertion of it even upon local grounds."

In the interest of brevity, we refer to our Summary at the beginning of Points I and II of Brief, page 48.

Section B. Taxation of affiliated corporations on a combined basis.

There is drawn in question in the above-entitled actions, and each of them, the validity of a statute of the State of Minnesota, namely, Chapter 405, Laws of Minnesota 1933, and especially Section 32 and sub-section (c) thereof in the form in which the legislature enacted said chapter and said section, on the ground of its being repugnant to the Constitution of the United States and amendments thereof, especially the Four-

teenth Amendment, Section 1, and the equal protection clause thereof.

In the Appendix, Exhibit A, we have set forth relevant excerpts from Chapter 405, Laws Minnesota 1933.

The disputed sentence of Section 32 (c) is for convenience repeated here:

> "If 90% of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission **may** impose the tax as though the combined entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but intercompany dividends shall in that event be excluded in computing taxable net income." (Emphasis supplied.)

The state supreme court treated this statutory provision as a penalty and not as an aid in arriving at true taxable income. The court said in the Oliver case, 207 Minn. 630, at page 636, 292 N. W. 407, at pages 410, 411:

> "Without defining the conditions which the commission must find before it could impose a penalty, the legislature could not, as the state claims, leave the imposition of the penalty to the discretion of the commission. There would be an unconstitutional delegation of legislative powers. A. L. A. Schechter Poultry Corp. v. United States, 295 U. S. 495, 55 S. Ct. 837, 79 L. ed. 1570, 97 A. L. R. 947. There would also be a lack of uniformity which would violate our constitutional requirements (Minn. Const. art. 9, sec. 1, as well as U. S. Const. Amend. XIV) if discrimination resulted. We therefore give the statute an interpretation in harmony with the constitution."

The syllabus prepared by the court, No. 3, at page 630 is as follows:

> "It would be an unconstitutional delegation of legislative power to authorize the tax commission in its discretion to impose a penalty without a legislative definition of the conditions which it must find to exist before such penalty could be assessed. And

> if the imposition of the penalty be left to the uncontrolled discretion of the commission and resulted in discrimination, it would be a violation of our constitutional uniformity clause and of the XIVth amendment."

An analysis of the court's decision as we demonstrate in our Brief shows that the court was of the opinion that the purported penalty was left to the uncontrolled discretion of the commission because no conditions were defined in the statute "which the commission must find before it could impose" the penalty. Likewise since it was a "discretionary penalty" discrimination would inevitably result whenever the discretion to impose the penalty was exercised by the commission. This made it necessary in the eyes of the court to give the statute an interpretation in harmony with the Fourteenth Amendment. This the court proceeded to do by giving an **unnatural** meaning instead of a **natural** meaning to the permissive word "may" in Section 32 (c).

Section 32 (c) has been treated in the instant cases as if it were similar to the ordinance held violative of the equal protection clause of the Fourteenth Amendment in the case of **Yick Wo v. Hopkins**, 6 S. Ct. 1064, 118 U. S. 356, 30 L. ed. 220. In that case an ordinance of the City of San Francisco gave the Board of Supervisors authority at their discretion to refuse permission to carry on laundries except where located in buildings of brick or stone. This court said, 6 S. Ct. at page 1070, 118 U. S. at page 366, 30 L. ed. at pages 225-226:

> "* * *. It does not prescribe a rule and conditions, for the regulation of the use of property for laundry purposes, to which all similarly situated may conform. It allows, without restriction, the use for such purposes of buildings of brick or stone; but, as to wooden buildings, constituting nearly all those in previous use, it divides the owners or occupiers into two classes, not having respect to their personal character and qualifications for the business,

> nor the situation and nature and adaptation of the buildings themselves, but merely by an **arbitrary** line, on one side of which are those who are permitted to pursue their industry by the **mere will and consent** of the supervisors, and on the other those from whom that consent is withheld, at their **mere will and pleasure.** And both classes are alike only in this: that they are tenants at will, under the supervisors, of their means of living." (Emphasis supplied.)

In the interest of brevity and to avoid repetition we here summarize facts and arguments from Point III of our Brief, infra.

The state supreme court held that Chapter 405, Section 32 in the form in which it was enacted by the legislature is violative of the Fourteenth Amendment, Section 1, the equal protection clause being referred to by necessary intendment.

The Tax Commission in these cases levied the tax separately. The trial court sustained this holding.

The state supreme court erroneously ruled that Section 32 (c) was a penalty instead of a tax provision.

Statutory provisions similar to Section 32 (c) are common in state and federal tax laws. The cases from state courts and from lower federal courts cited in our Brief show that discretionary provisions for consolidated returns in the case of affiliated corporations are looked upon with favor by the courts. Such provisions are modern devices for coping with intricate corporate organizations.

Nowhere have we found any decision of the Supreme Court of the United States holding that such tax provisions are repugnant to Section 1 of the Fourteenth Amendment of the Constitution of the United States.

The state supreme court advanced several non-federal grounds for its decision on the points here involved.

None of these grounds are adequate to support the court's decision. Page 76, et seq., Brief.

The following two grounds are based on the State Constitution.

The Minnesota constitutional provision against delegation of legislative powers (Const. Art. 3) is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it. Page 76, et seq., Brief.

The state uniformity clause, Art. 9, Sec. 1, is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.

The state uniformity clause is identical with the equal protection clause of Section 1 of the Fourteenth Amendment.

According to the Minnesota court, the natural permissive interpretation of the word "may" is violative of the Fourteenth Amendment because in its permissive form it provides for the imposition of a penalty without defining the conditions which the commission must find before it could impose a penalty. Therefore, says the court, it is a violation of the "uniformity clause" of the state constitution. Therefore, says the court, it is also an unconstitutional delegation of legislative power.

However, if the natural permissive interpretation of the word "may" does not amount to a grant of power to impose a discretionary penalty, this provision is not violative of the Fourteenth Amendment. Therefore, it is not violative of the "uniformity clause" of the state constitution. Therefore also, it is not an unconstitutional delegation of legislative power.

Thus the rationale for all the constitutional objections, state as well as federal, breaks down when once it is de-

termined that the natural permissive interpretation of the word "may" is not a grant of discretionary power to impose a penalty.

The two non-constitutional grounds given by the court were intended as a necessary alternative to what it believed would be an interpretation of this provision rendering it unconstitutional. Only under the compulsion of such necessity was the court driven to giving the word "may" a mandatory instead of its natural permissive meaning. Because of such compulsion and because of such assumed necessity, the non-constitutional grounds cannot be treated as independent. This is more fully set forth in our Brief, infra.

The statutory construction of Section 32 (c) based on Wisconsin legislative history is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature of Minnesota enacted it. The court said, 207 Minnesota at page 634, 292 Northwestern at page 410:

> "It seems obvious that with that litigation in mind the Minnesota legislature attached the last sentence of subd. (c) for the purpose of making the powers and duties of the Minnesota tax commission clear; that it sought to give the Minnesota commission the power the Wisconsin commission claimed."

We agree with the Minnesota Supreme Court that the Minnesota legislature sought to give the Minnesota Tax Commission the powers that "the Wisconsin Commission claimed". However, it is clear that the Wisconsin Tax Commission never contended for a restriction of its powers. On the contrary it contended for expansion of its powers. What the Wisconsin Commission claimed was discretionary power to tax affiliated corporations upon a consolidated basis in cases where the facts were similar to those in the Curtis case. Curtis Company v. Wisconsin Tax Commission, 214 Wis. 85, 251 N. W. 497,

92 A. L. R. 1065. A careful study of the Wisconsin cases cited by the Minnesota court in its decision makes this very clear.

The statutory construction of Section 32 (c) based on the intention of the Minnesota Legislature to confer a power to be exercised for the benefit of the state or of a private party is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.

Nowhere does the court state or point out that the alleged benefit is for a private party.

The fact that the state does not derive any benefit from the mandatory taxation of affiliated corporations on a combined basis is fully demonstrated in our Brief, page 82, et seq.

The State questions in these cases are so interwoven with the Federal question as not to be independent matters.

Not only were none of the non-federal grounds suggested by the state court adequate to support the charge of unconstitutionality of Section 32 (c) but the questions, state and federal, were so interwoven as not to furnish an independent basis of decision on the points here involved.

We submit that there is more uncertainty in regard to the basis of the present decisions on the points here involved than was the case in **Minnesota v. National Tea Company**, 60 S. Ct. 678, 309 U. S. 551. In that case this court said, 60 S. Ct. at page 679, quoting from **State Tax Commission v. Van Cott**, 59 S. Ct. 605, 606, 306 U. S. 511, 514, 83 L. ed. 950:

> "* * * if the State court did in fact intend alternatively to base its decision upon the State statute and upon an immunity it thought granted by the Constitution as interpreted by this Court, these two

> grounds are so interwoven that we are unable to conclude that the judgment rests upon an independent interpretation of the State law."

As this court said in the next paragraph of the National Tea Company case (60 S. Ct. 679):

> "The procedure in those (sic) case was to vacate the judgment and to remand the cause for further proceedings, so that the federal question might be dissected out or the state and federal questions clearly separated."

In **Minnesota v. National Tea Company**, 60 S. Ct. 676, supra, this court vacated the judgment in order that the federal questions might be dissected out or the state and federal questions clearly separated and remanded the case for further proceedings.[8]

Section C. Inclusion of interest from federal securities in the measure of the Minnesota Corporate Franchise Tax.

There is drawn in question in the above-entitled actions of the State of Minnesota against Duluth, Missabe and Northern Railway Company et al. and The Duluth and Iron Range Railroad Company et al., the validity of a statute of the State of Minnesota, namely, Chapter 405, Laws of 1933, Section 12, which provides for the inclusion of income from federal securities, together with income from all other securities, with the sole exception of income from Minnesota state and local securities, in the measure of the Minnesota Corporate Franchise Tax, on the ground that it is repugnant to the federal constitutional immunity of federal securities from taxation by the states.

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[8]Following the remanding of the case by this court the Minnesota Supreme Court September 27, 1940, filed a per curiam opinion not published at this writing.

In the Appendix, Exhibit A, we have set forth relevant excerpts from Chapter 405, Laws Minnesota 1933, including the title and sections numbered 2, 3, 5, 8 and 12.

The taxes claimed due by plaintiff in its causes of action against each of these two defendants include in their measure the sum of $150,044.12 in the case of the Missabe and $214,066.12 in the case of the Iron Range received by them as income from federal securities.

In the Missabe case in its Answer (Substituted) (R. 292) the defendant alleged in Section 8 that there was included in plaintiff's claim" * * * interest received by the taxpayer upon obligations of the United States government in the sum of $150,044.12 which is immune from taxation both under the Constitution of the United States and the Acts of Congress of the United States and under the provisions of the Minnesota State Income Tax Act (Chapter 405, Laws Minnesota 1933)". It was the claim of the state that these federal securities were includable in plaintiff's cause of action and the plaintiff denied the immunity alleged under the Constitution of the United States as well as any immunity under the Minnesota Act.

Similar allegations and claims of immunity were made in the Iron Range case.

The trial court (R. 317) found that the interest above referred to in the Missabe case was included in defendant's income as set forth in plaintiff's amended statement (complaint) and at page (R. 318) in the Conclusions of Law found that defendant was not subject to any payment of any tax on any part of said income. Plaintiff (R. 354) moved the court for the inclusion of said income from federal securities in the sum of $150,044.12. The court (R. 368, f. 1) denied said motion (Assignment No. 25, Transcript page 1609).

Motions for Amended Findings and Conclusions of

Law were also made in the Iron Range case. Motion to Amend Conclusions of Law (R. 1375), Order Denying same (R. 1383), Assignment No. 29 (Tr. page 1628).

The claims of federal constitutional immunity made by defendants were at all times maintained throughout the trial and in the state supreme court and the claims of the state denying such immunity were at all times maintained in the state courts.

It is the contention of the petitioner that the state supreme court expressly and by necessary intendment construed and passed upon petitioner's federal claims with respect to the said federal constitutional immunity of federal securities from the Minnesota tax and that the said federal claims were duly raised and passed upon in said court.

The state supreme court denied plaintiff's claims and decided that defendants were entitled to the federal constitutional immunity with respect to their income from federal securities. The court based its decision upon two grounds, one federal and one non-federal. The court said in the railroad cases, **State v. Duluth, Missabe & Northern Railway Company**, 207 Minn. 618, at page 626, 292 N. W. 401, at page 406:

> "* * * the inclusion of income from tax-exempt securities as a measure of the tax is objectionable when it evidences an attempt to discriminate against income from a particular source."

In support of this basis of its decision, the court cited **Miller v. Milwaukee**, 272 U. S. 713, 47 S. Ct. 280, 71 L. ed. 487; **Schuylkill Trust Co. v. Pennsylvania**, 296 U. S. 113, 56 S. Ct. 31, 80 L. ed. 91. The court said further, same page:

> "The dissent in the latter case said that the discrimination must be either unfriendly in design, or in favor of securities in competition with federal securities included in the tax."

And further, same page:

> "It seems, in the instant case, that to allow taxation of federal government securities under subsection (g) would operate not only as a discrimination, but also as an unfriendly one, to the favor of local securities which are in fact in substantial competition with the federal securities."

The reference to "subsection (g)" has to do with the non-federal ground which we shall now refer to.

The court said, 207 Minnesota at page 626, 292 Northwestern at page 405:

> "Pertinent provisions of c. 405 are subsections (f) and (g) of sec. 12, exemptions from gross income:
>
> "(f) Interest upon obligations of the State of Minnesota, any of its political or governmental subdivisions, any of its municipalities, or any of its governmental agencies or instrumentalities.
>
> "(g) Income received from the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law."

The court said further, 207 Minnesota at page 626, 292 Northwestern at page 406:

> "Subsection (g) by expressly exempting income from federal securities so far as immune from state taxation under federal law, in effect, provides that such income shall not be included in the measure of the franchise tax. Although a state may constitutionally impose a franchise tax measured by income, including income from tax-exempt securities, Flint v. Stone Tracy Co., 220 U. S. 107, 31 S. Ct. 342, 55 L. ed. 389, Ann. Cas. 1912B, 1312, subsection (g) provides that such income shall not be included as a measure of the tax on the franchise."

Finally at 207 Minnesota 627, 292 Northwestern 406, the court said:

> "We therefore conclude that under any interpretation of subsection (g) income from federal securities should not be included in the measure of the tax on defendants' non-railroad income imposed by c. 405."

Now the remarkable thing about our situation is that subsection (*l*) of Section 12 which was not referred to by the court in its opinion had the effect of entirely removing subsection (g) from the list of exclusions from gross income in the measure of corporate franchise taxation. Subsection (*l*) provided:

> "Subdivisions (c), (d), (i) and (j) shall not apply to corporations, and subdivision (g) shall not apply to corporations taxable under Section 2, except so far as taxable under Section 8.

The corporations here involved are all taxable under Section 2 and are not taxable under Section 8. There is no dispute nor is there any question on that point.

Only corporations taxable under Section 2 pay a franchise tax measured by income. Corporations taxable under Section 3 pay a direct income tax. Section 8 provides for a direct income tax for those corporations whose taxable year expired prior to the effective date of the Minnesota Act, April 21, 1933, but which for subsequent years are required to pay a franchise tax under the provisions of Section 2.

Thus the Minnesota legislature made a careful and deliberate attempt to limit the inapplicability of the exclusion of income from the United States under subsection (g) to those corporations paying a franchise tax rather than a direct income tax.

After the court filed its decision in the railroad cases December 29, 1939, plaintiff called to the court's attention the fact that the court had "*** * * completely overlooked and failed to consider in any way whatsoever subsection (*l*) of section 12 of the Income Tax law. This subsection (*l*) is the one which specifically states that subdivision (g), which refers to the exclusion of income from federal securities in the computation of gross income, shall not apply to corporations.**" (Petition of Ap-

pellant for Rehearing filed January 18, 1940, page 12, Tr. page 1672.)

Plaintiff also at the same time and place called to the court's attention the fact that this point was fully discussed in the state's Supplemental Brief, pages 12-25.

Of course the state supreme court was under no duty to mention or comment upon the governing subsection (*l*). The court had advanced two bases for its decision, one federal, one non-federal. It may have considered its federal ground ample and therefore rested its decision upon that ground.

Following the said Petition of Appellant for Rehearing, the court filed another decision on April 26, 1940, also entitled **State v. Duluth, Missabe and Northern Railway Company,** 207 Minn. 637, 292 N. W. 411 (Tr. 1819 et seq.). In that decision the court made no mention of its omission to comment on subsection (*l*).

We believe that under these circumstances we are entitled to one of two conclusions with respect to the omission of any mention of the governing statutory provision subsection (*l*).

1. The court having advanced two alternative bases for its decision abandoned its non-federal ground when it found that it was entirely mistaken about subsection (g) and that subsection (g) did not exclude defendants' income from federal securities from the tax. This left only one basis, namely, the federal ground.

2. The court ignored subsection (*l*) and continued to base its decision alternatively on the federal and non-federal ground.

Under conclusion No. 1, we are before this court on a federal question because no other question exists.

Under conclusion No. 2, we respectfully submit that we are entitled to have this court examine the Minnesota statute especially section 12 and subsec-

tions (g) and (*l*) to determine whether or not the ignoring of the statutory provisions in such circumstances may not be regarded as essentially arbitrary.

We also submit that in any event such an unusual situation as this constitutes additional support for petitioner's argument that the two grounds advanced by the court are so interwoven that the non-federal ground may not be considered an independent matter.

We believe that the most reasonable explanation that can be furnished for ignoring subsection (*l*) is that the court rested on the federal ground and we are content with that explanation.

If, however, this court finds it necessary to examine further into the alternative bases advanced by the state court, we refer to the cases of **Minnesota v. National Tea Co.**, 60 S. Ct. 678, 309 U. S. 551; **State Tax Commission v. Van Cott**, 59 S. Ct. 605, 306 U. S. 511, 83 L. ed. 950.

We also call to the attention of the court the case of **Enterprise Irrigation District v. Farmers Mutual Canal Company**, 37 S. Ct. 318, 243 U. S. 157, 61 L. ed. 644, in which this court at page 320 of 37 S. Ct. said:

> "But where the non-federal ground is so interwoven with the other as not to be an independent matter or is not of sufficient breadth to sustain the judgment without any decision of the other our jurisdiction is plain."
>
> **"And this is true also where the non-Federal ground is so certainly unfounded that it properly may be regarded as essentially arbitrary,** or a mere device to prevent a review of the decision upon the Federal question." (Emphasis supplied.)

We, therefore, respectfully submit that (even if, under the circumstances, the Minnesota Supreme Court cannot

be said to have abandoned it), the non-federal ground set up in the Minnesota court's decision is so arbitrary and unfounded that it should not be considered as an adequate independent non-federal ground.

THE QUESTIONS PRESENTED.

QUESTION I.

The Minnesota Corporate Franchise Tax Act, Chapter 405, Laws 1933, is measured by net income and determined by gross income. Railroad and other gross income is differentiated, the distinction between them being "income derived from the exercise of the corporate franchise within the scope of railroad ownership or operation and that from its exercise without such scope." In 1933, pursuant to the Act of Congress of June 16, 1933, "Emergency Railroad Transportation Act 1933", 48 Stat. 220, defendant received from the United States $7,774,804.19 belonging to the United States, to which defendant, prior to said Act of Congress, had no title or interest legal or equitable.

Of this amount of $7,774,804.19, the sum of $5,808,256.61 consisted of trust funds belonging to the United States, held by defendant as trustee for the United States, transferred to the United States at various times during the years 1924 to 1930, pursuant to the Act of Congress of February 28, 1920, "Transportation Act 1920", 40 Stat. 488.

The question is whether or not the receipt of said sum of $5,808,256.61 by defendant under the provisions of said Act of Congress of June 16, 1933 constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

QUESTION II.

(The first paragraph of Question II is the same as the first paragraph of Question I and is here omitted for sake of brevity.)

Of this amount of $7,774,804.19, the sum of $1,966,547.58 consisted of accretions or earnings on moneys belonging to the United States, and which had never at any time been in the hands of the defendant.

The question is whether or not the receipt of said sums of $1,966,547.58 by defendant under the provisions of said Act of Congress of June 16, 1933, constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

QUESTION III.

All of the voting stock of defendants is owned by and under the legally enforceable control of the same interests. Section 32 (c) of Chapter 405, Laws Minnesota 1933, provides that:

> "* * *. If 90 per cent of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but inter-company dividends shall in that event be excluded in computing taxable net income." (Emphasis supplied.)

The Tax Commission assessed the tax separately on each corporation. It did not assess on a combined basis.

The question is whether or not the word "may" in said provision, when given its natural permissive meaning, renders said provision repugnant to the equal protection clause of Section 1 of the Fourteenth Amendment, Constitution of the United States.

QUESTION IV.

The question is whether or not Section 12, Chapter 405, Laws of Minnesota 1933, which provides for the inclusion of income from federal securities together with income from all other securities, with the sole exception of income from Minnesota state and local securities, in the measure of the Minnesota Corporate Franchise Tax, is repugnant to the immunity of federal securities from state taxation under the Constitution of the United States.

ASSIGNMENTS OF ERROR.

For the sake of brevity, we here refer to the Assignments of Error set forth in our Brief infra following the said Questions and the Points thereunder.

THE REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

There are special and important reasons why a review on Writs of Certiorari in these cases should be granted in the sound discretion of the court. In addition to the facts and argument submitted in our Petition and Brief, we urge further:

that the five actions before the court involved more than $400,000 of taxes for the year 1933;

that other substantial amounts for subsequent years are indirectly involved in connection with the questions relating to consolidated return;

that other substantial amounts of taxes of other large corporations are also indirectly involved in connection with the questions relating to consolidated return;

that other substantial amounts of taxes of other large corporations are also indirectly involved in connection with the question relating to the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise Tax;

that the state supreme court has decided federal questions of substance not heretofore determined by this court;

that the state supreme court has decided federal questions of substance in a way not in accord with applicable decisions of this court;

that the questions here presented are questions of substance.

WHEREFORE, your petitioner prays that Writs of Certiorari be issued out of and under the seal of this Honorable Court directed to the Supreme Court of the State of Minnesota commanding that court to certify and send to this court for its review and determination a full and complete transcript of the record and all proceedings in the said Supreme Court had in the cases numbered and entitled on its docket, respectively, No. 32125, State of Minnesota vs. Duluth, Missabe and Northern Railway Company, and Duluth, Missabe and Iron Range Railway Company; No. 32124, State of Minnesota vs. The Duluth and Iron Range Rail Road Company and Duluth, Missabe and Iron Range Railway Company; No. 32126, State of Minnesota vs. Spirit Lake Transfer Railway Company and Duluth, Missabe and Iron Range Railway Company; No. 32312, State of Minnesota vs. Oliver Iron Mining Company; and No. 32313, State of Minnesota vs. Proctor Water & Light Company; to the end that the decisions and judgments of said Supreme Court of the State of Minnesota and each of them may be reviewed and reversed by this Honorable

Court and that judgments may be entered for the State of Minnesota in each of said actions.

STATE OF MINNESOTA,
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Of Counsel for Petitioner.

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, A. D. 1940.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

THE DULUTH AND IRON RANGE RAIL ROAD COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

SPIRIT LAKE TRANSFER RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

OLIVER IRON MINING COMPANY, Respondent.

No.————

STATE OF MINNESOTA, Petitioner,

vs.

PROCTOR WATER & LIGHT COMPANY, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

STATEMENT OF THE CASE.

The facts of the five cases are, we believe, stated adequately in the foregoing petition for writs of certiorari.

The controlling questions in these cases are federal questions. The federal jurisdictional aspects of these cases have been covered in Sections A, B and C of the jurisdictional statement.

ARGUMENT.

QUESTIONS I and II.

Questions I and II may be conveniently discussed together.

QUESTION I.

The Minnesota Corporate Franchise Tax Act, Chapter 405, Laws 1933, is measured by net income and determined by gross income. Railroad and other corporate gross income is differentiated, the distinction between them being "income derived from the exercise of the corporate franchise within the scope of railroad ownership or operation and that from its exercise without such scope." In 1933, pursuant to the Act of Congress of June 16, 1933, "Emergency Railroad Transportation Act 1933", 48 Stat. 220, defendant received from the United States $7,774,804.19 belonging to the United States, to which defendant, prior to said Act of Congress, had no title or interest legal or equitable.

Of this amount of $7,774,804.19, the sum of $5,808,256.-61 consisted of trust funds belonging to the United States, held by defendant as trustee for the United States, transferred to the United States at various times during the years 1924 to 1930, pursuant to the Act of

Congress of February 28, 1920, "Transportation Act 1920", 40 Stat. 488.

The question is whether or not the receipt of said sum of $5,808,256.61 by defendant under the provisions of said Act of Congress of June 16, 1933 constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

QUESTION II.

(The first paragraph of Question II is the same as the first paragraph of Question I and is here omitted for the sake of brevity.)

Of this amount of $7,774,804.19, the sum of $1,966,-547.58 consisted of accretions or earnings on moneys belonging to the United States, and which had never at any time been in the hands of the defendant.

The question is whether or not the receipt of said sum of $1,966,547.58 by defendant under the provisions of said Act of Congress of June 16, 1933, constitutes gross income derived from the exercise of defendant's corporate franchise without the scope of railroad ownership or operation.

Points I and II may be conveniently discussed together.

POINT I.

(1) The Supreme Court of Minnesota erred in failing to give due effect to the Act of Congress of 1933, 48 Stat. 220, in failing to properly construe it and in failing to hold that the $7,774,804.19 income received by defendant, Duluth, Missabe and Northern Railway Company from the United States in 1933 was created by Congress and that its nature was determined by Congress.

(2) The Supreme Court of Minnesota erred in failing to give due effect to the Act of Congress of 1920, 41 Stat. 488, in failing to properly construe it and in failing to hold and recognize that said Act of Congress accomplished a complete cut-off and severance of the title and interest of defendant, Duluth, Missabe and Northern Railway Company in and to the funds transferred by it to the general railroad contingent fund.

(3) The Supreme Court of Minnesota erred in failing to give due effect to the decision of the United States Supreme Court in the case of **Dayton-Goose Creek R. Co. v. U. S.**, 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388, in failing to follow and apply it and in failing to hold and recognize that the Act of Congress of 1920, as construed and interpreted by the United States Supreme Court in said case, sustained said Act as accomplishing a complete cut-off and severance of the title and interest of defendant, Duluth, Missabe and Northern Railway Company, in and to the funds transferred by it to the general railroad contingent fund.

(4) The Supreme Court of Minnesota erred in holding that the sum of $5,808,256.61 was derived from the exercise of defendants' corporate franchise within the scope of railroad ownership or operation.

(5) The Supreme Court of Minnesota erred in holding that "the repayment amounts to nothing more than the return to defendants of their own railroad earnings. The restoration reinstated the earnings in their original status."

POINT II.

(Sections (1), (2), (3) and (5) of Point II are the same as Sections (1), (2), (3) and (5) of Point I and are therefore omitted for the sake of brevity.)

(4) The Supreme Court of Minnesota erred in holding that the said sum of $1,966,547.58 was derived from the exercise of defendant's corporate franchise within the scope of railroad ownership or operation.

POINTS I. AND II. SUMMARY.

1. Plaintiff's cause of action against Duluth, Missabe and Northern Railway Company is measured and determined by the net income of defendant. Net income is determined by gross income.
2. The item of $7,774,804.19 of gross income of defendant Duluth, Missabe and Northern Railway Company is an essential and substantial element of plaintiff's cause of action.
3. This portion of defendant's income and this element of plaintiff's cause of action is created by, and the nature of the element is determined by, Acts of Congress.
4. Non-railroad income is includable under the Minnesota Income and Franchise Tax Act.
5. The recapture fund, principal and accretions, is non-railroad income.
6. Income was differentiated under the Minnesota Act as construed by the state supreme court.
7. Under this differentiation non-railroad income is income derived from the exercise of the corporate franchise without the scope of railroad ownership or operation.
8. A distinctive character of the exercise of the corporate franchise is required under the Minnesota Statute in exercising the corporate franchise for railroad purposes.
9. The corporate franchise was not exercised for railroad purposes in the acquisition of any part of the $7,774,804.19 received from the United States.

10. The state supreme court placed all of this income in the category of railroad income.
11. The state supreme court erroneously construed the Acts of Congress.
12. The state supreme court must construe the Acts of Congress correctly.
13. Failure to do so raises a federal question.
14. The state supreme court expressly or by necessary intendment passed upon petitioner's federal claims relating to the Acts of Congress.
15. However, the federal questions involved were raised by both sides from the beginning of the litigation. Plaintiff specially set up the federal questions relating to the Acts of Congress.
16. The rights of petitioner specially set up, passed on by the state supreme court and denied to the petitioner, included the following:
    (a) The court failed to give due effect to the Act of Congress of 1933;
    (b) The court failed to properly construe said Act;
    (c) The Court failed to give due effect to the Act of Congress of 1920;
    (d) The court failed to properly construe said Act;
    (e) The court failed to give due effect to the case of Dayton-Goose Creek R. Co. v. United States;
    (f) The court failed and refused to hold that plaintiff was entitled to have all non-railroad income included as a part of its cause of action;
    (g) The court failed and refused to hold that there had been a complete cut-off and severance of the payments made by defendant to the United States for the years 1922 to 1929 amounting to $5,808,256.61;

(h) The court failed and refused to hold that the Act of Congress of 1933 was confirmatory of said complete cut-off and severance;

(i) The court failed and refused to hold that the accretions amounting to $1,966,547.58 had not even passed through the hands of defendant until the distribution by Congress in 1933;

(j) The court failed and refused to hold that the receipt by defendant from the United States of the $7,774,804.19 in 1933 was due solely to the Act of Congress and not to any exercise of the corporate franchise of defendant for railroad purposes.

17. This is not a case where the legislature undertook to characterize certain non-railroad income as railroad income.

18. There is no adequate non-federal ground for the state supreme court's decision on the points here involved.

19. The United States Supreme Court is not concluded by the state court's interpretation of the facts involving the funds received by defendant from the United States.

20. The other defendant corporations are affected in connection with the issue of consolidated return.

POINTS I. AND II. ARGUMENT.

For convenience and brevity we are combining in this argument the interrelated subdivisions of Points I and II.

For the sake of brevity, we here refer to our jurisdictional statement at page 10, et seq., supra, and ask leave to incorporate the same herein. We shall here especially discuss points 5, 6 7, 8, and 9 of the above Summary.

We shall now develop here in more detail our position that the $7,774,804.19 paid by the United States to defendant, Duluth, Missabe and Northern Railway Company, the so-called principal as well as the accretions, is non-railroad income.

The differentiation of railroad and non-railroad income under the Minnesota Income and Franchise Tax Act as construed by the state supreme court.

The Minnesota Income and Franchise Tax Act contains no express differentiation of railroad and non-railroad income. The language of the Act is all inclusive but the state supreme court construing the Act says that the purpose of the legislature in not exempting railroad corporations **"must have been to assure taxation of any income not attributable to railroad ownership or operation."** 207 Minn. at page 625, 292 N. W. at page 405. (Emphasis Supplied.)

Accordingly, pursuant to this legislative purpose to assure taxation of income not attributable to railroad ownership or operation the state supreme court differentiates railroad income from non-railroad income.

In the opinion of December 29, 1939, 207 Minn. 618, 624, 625, 292 N. W. 401, 405, that court said:

> **"If a railroad exercise its corporate franchise for railroad purposes and also for non-railroad purposes that part of its exercise for non-railroad purposes cannot escape taxation.** It follows that railroads may not be subject to the franchise tax imposed by c. 405 measured by income from railroad ownership or operation because for such exercise of the franchise the gross earnings tax is exclusive, but that **they are subject** thereto **insofar as the franchise is exercised,** whether ultra vires or not, **for other than railroad purposes.** That part of the franchise so exercised is as separable, as much subject to ordinary taxes, as is any non-railroad property. **The purpose of the legislature in not listing railroads among the exempt must have been to assure taxation of any**

> **income not attributable to railroad ownership or operation."** (Emphasis Supplied.)

In its December 29, 1939, opinions in these cases, supra, 207 Minn. page 624, and 292 Northwestern page 404, the state supreme court said:

> "Any property owned by the railroad, but used for a **non-railroad purpose,** is subject to ordinary ad valorem property taxation. County of Todd v. St. P. M. & M. Ry. Co., 38 Minn. 163, 36 N. W. 109; State v. Minnesota & I. Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, * * *." (Emphasis Supplied.)

In the same opinion, 207 Minnesota, at page 624, and 292 Northwestern, at page 405, the court said:

> "Holding that the franchise is property and that a tax upon it is a property tax, we must also hold, in accordance with prior holdings as to property not owned or used for **railroad purposes,** that such property is subject to ordinary taxation. To do otherwise would cause inconsistency with well settled rules in this state. City of St. Paul v. St. P. M. & M. Ry. Co., 39 Minn. 112, 38 N. W. 925; County of Ramsey v. C. M. & St. P. Ry. Co., 33 Minn. 537, 24 N. W. 313; State v. N. W. Tel. Exch. Co., 84 Minn. 459, 87 N. W. 1131. * * *"[9] (Emphasis Supplied.)

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[9]**The County of Todd case,** cited above by the state supreme court in its opinions of December 29, 1939, in the instant cases, is one of a considerable number of decisions by the Minnesota Supreme Court that throws light on the meaning of "railroad purposes." At pages 166 and 167 of the opinion in the County of Todd case the court said:

> "No very precise rule can be laid down by which it can be determined, in all cases, whether land acquired for railroad purposes is or is not within such an exemption. **The mere fact that it was acquired and used for purposes connected with the road would not necessarily determine its exemption.** Many branches of industry might be made serviceable in connection with the operations of a railroad, and property be devoted to various uses, which could hardly be supposed to have been contemplated, when the corporation was created, as being within the scope of its powers. Such might be the case with respect to the purchase and working of iron mines, forges, the rolling-mills, the erecting of residences for the use of its officers and employees, under ordinary circumstances; the building up of towns along the route to affect the location of centres of popu-

In the opinion of April 26, 1940, 207 Minnesota, at page 639, 292 Northwestern, at page 412, the state supreme court discussed the differentiation of railroad and non-railroad income. It said that the phrase "non-operating income" was not appropriate "to distinguish non-railroad income from that derived from the exercise of the corporate franchise for railroad purposes." That **"the distinction should lie between income derived from the exercise of the franchise within the scope of railroad ownership or operation and that from its exercise without such scope."** The court suggests the use of the phrases "railroad income" and "non-railroad income" to indicate this differentiation. (Emphasis Supplied.)

The corporate franchise was not exercised for railroad purposes in the acquisition of the $7,774,804.19 from the United States.

The corporate franchise "to be" is exercised in merely "being."

The corporate franchise "to do" of a railroad corporation is exercised when powers contained in the articles of incorporation are exercised for **railroad purposes.** Obviously the exercise for railroad purposes is not intended to include merely "being" nor is it intended to include such exercise as is essential to every transaction, whether railroad or otherwise.

A distinctive character of exercise is contemplated and described by the words "for railroad purposes."

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lation and business, and thus to promote the business and the interests of the company. * * *

"The purchase of the lands in question could not, we think, be deemed, in any proper sense of the word, necessary for the prosecution of this enterprise, nor was it such an ordinary appropriation of property to the purposes of the railroad as to come within the reason and scope of the exemption." (Emphasis supplied.)

No distinctive character of exercise of the corporate franchise of defendant was required in the receipt by defendant from the United States of the sum of $1,966,547.58 accretions to the general railroad contingent fund owned by the United States. Nor was any such distinctive character of exercise required in receiving the other portion of the $7,774,804.19 from the United States in 1933.

The fact that in 1922 or 1929 defendant had received railroad income of which a portion had been transferred to the United States pursuant to the act of 1920 furnishes no basis for defendant's claim that the payment by the United States in 1933 was derived from the exercise of the corporate franchise for railroad purposes in 1933. A simple illustration will show that such superficial or figurative relationship will not avail defendant. E.g. a railroad earns income from its railroad business. It segregates a portion of net earnings and invests it in industrial bonds. It receives income from these bonds. The corporate franchise is, of course, exercised in receiving and collecting a check for the interest but that is not the exercise of the corporate franchise "for railroad purposes." The income from the bonds is not "derived from the exercise of the franchise within the scope of railroad ownership or operation."

The state supreme court has recognized that such interest is not "derived from the exercise of the franchise within the scope of railroad ownership and operation" by its April 26, 1940, decision citing **State v. N. P. Railway Company**, 139 Minn. 473, 167 N. W. 294, and **State v. G. N. Railway Company**, 139 Minn. 469, 167 N. W. 297, which involved the taxation of investments made from railroad earnings.

The Minnesota Supreme Court recognizes that the mere fact that the investment once came from railroad

earnings, that is, from the exercise of the corporate franchise within the scope of railroad ownership and operation, **does not stamp the income** from such investment with the character of income derived from the exercise of the corporate franchise within the scope of railroad ownership and operation. If it were otherwise, then **no** investment could ever produce non-railroad income. The court clearly makes a distinction between income from investment on the one hand and income from direct railroad operations or income produced by working capital on the other hand.

The income amounting to $7,774,804.19 was derived solely from the Act of Congress of 1933. **No** exercise of defendant's corporate franchise for railroad purposes was required nor involved in creating this income.

If the word "derived" be construed to mean mere receipt, then the receipt was derived **not** from exercise of corporate franchise for railroad purposes but from the mere exercise of the corporate franchise without the qualification "for railroad purposes" and without reference to purposes, railroad or otherwise. This is proved by the fact that **no corporate franchise at all was necessary to receive the funds. The corporation might have discontinued all railroad operations. It might in fact have been dissolved and succeeding interests in the liquidation would have received the funds.**

To say that such mere receipt represents the exercise of the corporate franchise for railroad purposes is to render the words "railroad purposes" meaningless.

The $7,774,804.19 was property of the United States in 1933. This proposition must be regarded as a fact. The underlying factual data together with the Acts of Congress and the decision of this court in the Dayton-Goose Creek case, produced the resulting fact of ownership in the United States.

It was further a fact that this money was not distributed by the United States to defendant in 1933 as payment for transporting mails or for any activity of defendant in the exercise of its corporate franchise for railroad purposes and that it was not "derived" from the United States as a result of such exercise.

Of the moneys received by defendant, Duluth, Missabe and Northern Railway Company from the United States amounting to $7,774,804.19, the sum of $1,966,547.58 constituted accretions or earnings of funds belonging to the United States and acquired under the Act of Congress of February 28, 1920, 41 Stat. 488.

The remainder of the moneys received from the United States by the defendant amounting to $5,808,256.61, was the equivalent of the total of moneys paid by the defendant into the fund during the years 1924 to 1930 and which moneys became property of the United States prior to the time when the moneys were paid by defendant to the United States under the 1920 Act.

In the case of the so-called principal amount, namely, $5,808,256.61:

the money was originally held by defendant in trust for the United States during the years 1920 to 1930;

the moneys so held in trust for the United States during said years were transferred and paid over to the United States from time to time during the years 1924 to 1930 as set forth on page 74 Record, Volume I, Case 32125, hereinbefore in our jurisdictional statement set forth at page 24;

the money was transferred to the United States according to the Act of Congress of 1920;

defendant had no title to the money, legal or equitable. **Dayton-Goose Creek R. Co. v. U. S.**, 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388;

defendant never received any of the money pursuant to the provisions of the Act of Congress of 1920;
the purpose of Congress was changed;

in 1933, pursuant to the Act of Congress of 1933, the money was distributed to those who had made transfers to the fund;
this distribution was made to defendant without regard to any exercise on its part of railroad ownership or operation.

To say that the accretions or earnings of the principal of such fund were derived from the exercise of defendant's franchise within the scope of railroad ownership or operation would be as superficial and baseless as saying that the bond interest in the illustration given above was derived from the exercise of the corporate franchise within the scope of railroad ownership or operation.

If the $7,774,804.19 or the $5,808,256.61 or the $1,966,547.58 received in 1933 were ordinary railroad receipts, no federal question would arise. But neither the $5,808,256.61 nor the $1,966,547.58 were receipts from the railroad business, ordinary or otherwise.

As we have seen, $1,966,547.58 of the amount paid by the United States to defendant Duluth, Missabe and Northern Railway Company was a portion of certain accretions and earnings acquired by the United States from and upon property exclusively owned by and exclusively belonging to the United States.

This money belonged to the United States. It was not income upon property belonging to defendant or to which defendant had any title, legal or equitable. The payment to defendant depended only and solely upon the Congress of the United States which by the Act of June 16, 1933, 48 Stat. 220, directed the payment. No railroad activity was necessary to condition receipt of the money by de-

fendant. It was not necessary that defendant he a railroad corporation. It was not even necessary that defendant be a corporation at all.

The corpus of the railroad contingent fund had been acquired by the United States under the 1920 Act. The accretions to the corpus, as well as the corpus itself, was distributed solely as a result of the Act of 1933. The corpus of the fund belonging to the United States was established by the Act of Congress of 1920. Accretions to it resulted from that Act. A portion of the accretions and a portion of the corpus were distributed to defendant by the Act of Congress alone.

The essential nature of the transaction resulted in income to defendant derived **not** from railroad ownership or operation but from the exercise of the corporate franchise **without** the scope of railroad ownership or operation.

The definition of non-railroad income under the Minnesota Act when applied to the funds distributed by the United States to defendant, Duluth, Missabe and Northern Railway Company in 1933 pursuant to the Act of Congress of that year, results inevitably in placing the entire $7,774,804.19 in the category of non-railroad income.

Were it not for the Acts of Congress and said decision of this court, the moneys transferred by the Duluth, Missabe and Northern Railway Company to the United States in the years 1924 to 1930 amounting to an aggregate of $5,808,256.61, would have been the company's own and would not have been income in 1933. The accretions amounting to $1,966,547.58 would not have existed. **We can only speculate on the use that might have been made by the company of the additional funds saved by non-liability for the Transportation Act payments.**

The $7,774,804.19 was an essential element of plain-

tiff's causes of action but only because of the Acts of Congress as interpreted by the United States Supreme Court. Eliminate the conditioning and determining effect of the Acts of Congress and no element of cause of action remains with respect to the sums saved in 1922 to 1929 and **the possible substitutes for the $1,966,547.58 accretions remain unknown and unpredictable.**

This, we submit, is a test of the federal question. An essential element of plaintiff's causes of action is dependent upon the Acts of Congress. Plaintiff's causes of action are as much dependent upon the federal statutes as were the causes of action in the Yates cases, **Jones National Bank v. Yates,** 36 S. Ct. 429, 240 U. S. 541, 60 L. ed. 788 and **Yates v. Jones National Bank,** 27 S. Ct. 638, 206 U. S. 158, 51 L. ed. 1002, one of which was referred to in Section A of the statement as to jurisdiction, supra. In those cases the elements of defendants' liability were controlled by and tied to an act of Congress and a federal question was held to exist.

Applying the definitions of railroad and non-railroad income fixed by the state supreme court in its interpretation of the income and franchise tax act, and applying and bearing in mind the nature of the so-called recapture fund, we find that the state supreme court has ignored the Acts of Congress of 1920 and 1933 and the decision of this court in the Dayton-Goose Creek case.

It is conceivable that the state supreme court might have found a different principle of differentiation of income, but it did not do so. Interpreting the state law as it did, it came to the conclusion as it said, 207 Minnesota, page 639, 292 Northwestern, page 412:

> "The distinction should lie between income derived from the exercise of the franchise **within** the scope of railroad ownership or operation and that from its exercise **without** such scope." (Emphasis supplied.)

It may be said that the state supreme court might have made a more inclusive definition of railroad income and a less inclusive definition of non-railroad income. The answer to this possible suggestion is: First, that it did not do so; second, that the past decisions of the court, as we have seen, tended to keep the definition of railroad income within bounds, and, third, we have a right to assume, and we do assume, that the definition and principle of differentiation adopted by the state supreme court was a considered definition and principle which would not require modification merely because of the result of its application. We have a right to assume, and we do assume, that if the state supreme court had correctly construed the facts and the Act of Congress and had correctly applied the definition, the result would have been, not to change the definition, but to place the $7,774,804.19 received from the United States in the non-railroad category.

QUESTION III

All of the voting stock of defendants is owned by and under the legally enforceable control of the same interests. Section 32 (c) of Chapter 405, Laws Minnesota 1933, provides that:

> "* * *. If 90 per cent of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but inter-company dividends shall in that event be excluded in computing taxable net income."

The Tax Commission assessed the tax separately on each corporation. It did not assess on a combined basis.

The question is whether or not the word "may" in said provision, when given its natural permissive mean-

ing, renders said provision repugnant to the equal protection clause of Section 1 of the Fourteenth Amendment, Constitution of the United States.

POINT III. Relating to taxation of affiliated corporations on a combined basis.

(1) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, and Section 32, and especially Section 32 (c) thereof, in its permissive form as enacted by the legislature, is invalid because violative of the Fourteenth Amendment, Section 1.

(2) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, including Section 2 thereof, and including Section 32 and subsection (c) thereof, violated the Fourteenth Amendment, Section 1, if Section 32 (c) in conjunction with the remainder of said Section 32 of said Chapter 405, were construed as permissive.

(3) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, including Section 2 thereof, and including Section 32 and subsection (c) thereof, violated the Fourteenth Amendment, Section 1, unless Section 32 (c) in conjunction with the remainder of said Section 32 of said Chapter 405, were construed as mandatory.

(4) The Supreme Court of Minnesota erred in holding that the granting to the Minnesota Tax Commission of discretionary power to impose a tax on a combined basis pursuant to Section 32, Chapter 405, Laws of Minnesota 1933, is violative of the United States Constitution, Fourteenth Amendment, Section 1.

(5) The Supreme Court of Minnesota erred in holding that Chapter 405, Laws of Minnesota 1933, especially Section 32 (c) thereof in the form in which the legisla-

ture enacted it, imposed a penalty and not a tax and was therefore in violation of the Fourteenth Amendment, Section 1, equal protection clause.

POINT III. SUMMARY.

1. The state supreme court held that the granting by the Minnesota legislature to the State Tax Commission of discretionary power to impose a tax on affiliated corporations on a combined basis pursuant to Section 32 (c) of Chapter 405, Laws of Minnesota 1933, was violative of Section 1 of the Fourteenth Amendment of the United States Constitution.
2. The basic federal question is that Chapter 405, Laws 1933, especially Section 32 (c) thereof in the form in which it was enacted by the legislature is violative of the Fourteenth Amendment, Section 1, equal protection clause.
3. The Tax Commission in these cases levied the tax separately. The trial court sustained this holding. The state supreme court reversed the trial court.
4. The state supreme court erroneously ruled that Section 32 (c) was a penalty provision instead of an aid in determining true taxable income. This error permeates the entire decision on this branch of the cases.
5. Statutory provisions similar to Section 32 (c) are common in state and federal tax laws. Discretionary power granted to taxing authorities in accordance with such provisions have been upheld by both state and federal courts.
6. When Section 32 (c) is given its natural permissive meaning it becomes a sharper and more efficient tool in dealing with intricate corporate combinations, not for the purpose of penalizing them, but for

the purpose solely of reaching the true taxable net income of such organizations.

7. The state supreme court advanced several non-federal grounds for its decision on the points here involved. None of these grounds are adequate to support the court's decision.
8. The Minnesota constitutional provision against delegation of legislative powers (Const. Art. 3) is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
9. The state uniformity clause, Art. 9, Sec. 1, is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
10. The state uniformity clause is identical with the equal protection clause of Section 1 of the Fourteenth Amendment.
11. The statutory construction of Section 32 (c) based on Wisconsin legislative history is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature of Minnesota enacted it.
12. The statutory construction of Section 32 (c) based on the intention of the Minnesota Legislature to confer a power to be exercised for the benefit of the state or of a private party is neither an adequate nor an independent ground for invalidating Section 32 (c) in the form in which the legislature enacted it.
13. The non-constitutional grounds were advanced by the court only as a necessary alternative to the natural and permissive meaning of Section 32 (c). Only under the compulsion of such necessity was the court driven to a mandatory alternative. Because of such compulsion and because of such assumed

necessity, the non-constitutional grounds cannot be treated as independent.

14. If neither the Fourteenth Amendment, Section 1, nor the state constitutional provisions are obstacles to a permissive interpretation of Section 32 (c), then there is no longer any need to seek an alternative to the natural meaning of the discretionary provision.
15. Therefore there is no need to interpret "may" as "must" in Section 32 (c).
16. The state questions in these cases are so interwoven with the federal questions as not to be independent matters.

POINT III ARGUMENT.

For the sake of brevity, we here refer to our jurisdictional statement at page 25, et seq., supra, and ask leave to incorporate the same herein.

The basic federal question on this branch of the cases is that Section 32 (c) of Chapter 405, Laws of Minnesota 1933, in the form in which it was enacted by the legislature is repugnant to the Fourteenth Amendment, Section 1, equal protection clause.

In the Appendix, page 105, et seq., we have set forth excerpts of this statute. The law imposes an income and franchise tax on individuals and corporations. The state supreme court sustained the Act against certain claims that it violated the equal protection and due process clauses of the Fourteenth Amendment and the uniformity clause of the Minnesota Constitution.[10]

In the instant cases (syllabus No. 2, 207 Minn. 618, 619, syllabus No. 3, 292 N. W. 401) the court holds the tax to

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[10]Reed v. Bjornson, 191 Minn. 254, 253 N. W. 102, supra; Thompson-Parker Holding Company v. Bjornson, 191 Minn. 271, 253 N. W. 110, supra.

be a "property tax" upon the corporate franchise of the corporation measured by net taxable income.

The Tax Commission in all of the present five cases assessed the tax separately.[11] Defendants claim that under Section 32 (c) they together with 75 other subsidiaries of the United States Steel Corporation were entitled as a matter of right to a consolidated basis of taxation.

The trial court sustained the claim of the state and held that defendants were not entitled as a matter of right to a consolidated basis.

It was the claim of defendants (see their Answers (substituted) pages 293 et seq. and similar Answers in the other cases) that failure and refusal of the Tax Commission to tax on a consolidated basis would deny to defendants the equal protection of the laws and would deprive them of their property without due process of law contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States as well as violate certain state constitutional provisions. Record, pages 289-290 in Case 32125.

For convenience we repeat here the second sentence of Section 32 (c):

> "If 90 per cent of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined

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[11]The taxes assessed for the year 1933 exclusive of interest were: Duluth, Missabe and Northern Railway Company, $569,751.99, Exhibit 2 attached to plaintiff's statement (Complaint), Record page 35, in Case 32125; The Duluth and Iron Range Railroad Company, $75,049.96, Exhibit 2 attached to plaintiff's statement, Record page 1329, in Case No. 32124; Spirit Lake Transfer Railway Company, $2,012.46, Exhibit 1 attached to plaintiff's statement, Record page 1428, in Case 32126; Oliver Iron Mining Company, $1,591.77, Exhibit 1 attached to plaintiff's statement, Record page 5 in case 32312 (Tr. 500), Proctor Water & Light Company, $1,344.48, Exhibit 2 attached to plaintiff's statement, Record page 51 in case 32313 (Tr. 1546).

> entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but intercompany dividends shall in that event be excluded in computing taxable net income."

The state supreme court held that the granting of discretionary power to the Tax Commission to calculate the tax on a combined basis in accordance with Section 32 was repugnant to the Fourteenth Amendment, Section 1.

The state supreme court further held that such power was the power to impose a penalty rather than a tax. The court said, 207 Minn. 630, at page 635, 292 N. W. 407, at page 410:

> "* * * It would appear that subdivisions (a) and (b) of Section 32 provide **penalties** which the legislature intended for tax evasion by corporations." (Emphasis supplied.)

Subsection (a), of course, relates to a penalty but no other provision relates to a penalty. And no party to these cases, plaintiff or defendant, ever claimed that either subsection (b) or any part of subsection (c) was a penalty.

The court further refers to "penalty" in relation to subsections (b) and (c) in the following instances on pages 635 and 636 of the decision in 207 Minnesota, and pages 410 and 411 of 292 Northwestern:

> "We are convinced that the Minnesota legislature did not intend by the last sentence of subdivision (c) to impose a discretionary **penalty** on affiliated corporations in addition to the 10% penalty authorized in Section (a) against the use of corporations for splitting up income."
>
> "Certainly we should not imply such additional **penalty** if it is one from the mere fact that subdivision (c) is associated with **penalizing** subdivisions."
>
> "No attempt is made in subdivision (c) to define the character of any tax evasion for which the

claimed penalty may be imposed by the commission, * * *."

"It is significant that counsel for the state cannot suggest any concrete example of tax evasion peculiar to affiliated corporations and not described in and penalized by subsections (a) and (b) in imposing the combined tax upon affiliated corporations."

"To us it seems clear that the legislature intended a tax always to be imposed and not a penalty for some undefined evasion."

"Without defining the conditions which the commission must find before it could impose a penalty the legislature could not, as the state claims leave the imposition of the penalty to the discretion of the commission." (Emphasis supplied)

Thus it will be seen that the decision of the Minnesota Supreme Court is based upon its failure to distinguish between a discretionary tax of affiliated corporations upon a consolidated basis and the imposition of a discretionary penalty upon such corporations. The court was evidently of the opinion that the grant of discretionary or permissive power to a tax commission to calculate the tax upon a combined basis under the circumstances stated in Section 32 constituted the imposition of a penalty upon the corporation or corporations thus taxed.

The court failed to recognize that under the present-day complexity of intercorporate transactions, there are many possibilities of not merely wilful but also of unintentional tax evasion and that in many instances the true taxable income of corporations belonging to an affiliated group could best be determined by calculation of the tax on a combined basis.

It is clear that in a proper case taxation upon a combined basis would be a very convenient and useful method in reaching true taxable net income and at the same time avoid intricate accounting problems whose attempted solution might otherwise bring on long drawn-out litigation.

The need for the granting of such discretionary power to tax commissions for the purpose of arriving at the true taxable income of a corporation affiliated with other corporations has been recognized in the tax laws of a large number of states.

Statutory Provisions Similar to Section 32 (c) are common in state and federal tax laws.

For instance the tax law of New York, Title 59 of the New York Code, Art. 9-a, No. 211, whose heading is "Reports of Corporations to Tax Commission," second paragraph of subsection 9, is as follows:

> "The Tax Commission may permit or require the filing of a combined report where substantially all the capital stock of two or more corporations liable to report under this article is owned or controlled by the same interests. The Tax Commission **may impose the tax provided by this article as though the combined entire net income and segregated assets were those of one corporation,** but in the computation dividends received from any corporation whose assets, as distinguished from shares of stock, are included in the segregations, shall not be included in net income, **or may, in such other manner as it shall determine, equitably adjust the tax."** (Emphasis supplied)

Also No. 214 headed "Computation of Tax," subsection 7, is as follows:

> "In case any report is made as provided by Paragraphs nine, ten, or twelve of Section two hundred eleven (211) of this chapter, **the Tax Commission may assess the tax against either of the corporations whose assets or net income are involved in the report upon the basis of the combined entire net income and the combined segregated assets of the corporations,** and upon such other information as it may possess, **or may adjust the tax in such** other manner as it shall determine to be equitable." (Emphasis supplied)

Thus the State of New York has granted its tax commission the discretionary power either to tax affiliated corporations upon a combined basis or else to adjust the tax in such other manner as it chooses.

These provisions of the New York law were discussed by the New York Court of Appeals in the case of **People ex rel Studebaker Corporation of America v. Gilchrist,** 244 N. Y. 114, 155 N. E. 68.

In an opinion by Justice Cardozo, the court said, page 71:

> "If the first and third paragraphs do not sustain the tax, there can be little basis for argument that the second paragraph applies. That paragraph assumes the existence of two corporations, both owned by like intersts and both subject to taxation. It assumes that the two shall join in a single or combined report, **and the tax then laid upon the two, or divided between them according to some equitable adjustment."** (Emphasis supplied)

It will be noted that in this opinion Justice Cardozo nowhere questions the validity of the discretionary combined basis if the taxpayer in question is subject to the state jurisdiction. However, it was decided in that case that the defendant was a foreign corporation not within the jurisdiction of the state.

The dissenting opinion of Justice Crane at pages 73-74 quoted in the following note further bears out the fact that the validity of such discretionary combined basis was not questioned.[12]

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[12]"This case, in my judgment, comes within sub-division 9 of Section 211 of the Tax Law, and subdivision 7 of Section 214. • • •

A method specifically provided for corporations coming within these subdivisions is not improperly or illegally used to ascertain net profits under such conditions as here exist, although the condition may not be specifically stated in the statute. The commission had a duty to discharge and that was to ascertain what would have been the net profit under a fair agreement with the holding or parent company. In the absence of other means of ascertainment or of other informa-

Judge Learned Hand in the case of **Procter & Gamble Co. v. Newton,** 289 Fed. 1013, in the Fed. District Court for the Southern District of New York referred to Section 211, Subdivision 9 of Article 9-A of the New York Tax Law (consolidated laws Chapter 60) as amended by Laws 1920, Chapter 640, Section 3, and amended by Laws 1922, Chapter 507, Section 1. Section 211 provided for consolidated reports of affiliated corporations. The question was whether or not Section 211 extended the scope of Section 209 to cover the plaintiff parent corporation which was alleged not to be doing business in the state.

However, the court in the following quotations recognized the validity of discretionary taxation of affiliated corporations on a combined basis. The court said in regard to the New York Law, page 1014:

> "It **does direct** such corporations to file a 'consolidated report' of the 'combined net income,' but it **only authorizes** the commission to impose the tax provided by this article as though the entire net income and segregated assets were those of one corporation." (Emphasis supplied)

And at page 1015:

> "Subdivision 9 of Section 211 was designed, I should suppose, merely to allow the commission to estimate the income of a subsidiary in the case therein provided by **another standard.** That would be a proper enough course since the subsidiary's privilege of doing business within the state is always conditional on such terms as it chooses to impose." (Emphasis supplied)

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tion furnished by the relator, it was justified in adopting the figures which were given and arriving at the net profits according to the methods used in other or similar cases. If the parent company had been doing business directly in New York state, there is no question about the correctness of the methods adopted by the Tax Commission."

The tax laws of California contain a similar provision. The first paragraph of sec. 14, Chapter 836, Laws 1937 of the State of California is as follows:

> "In case of two or more corporations, or one or more corporations owned or controlled directly or indirectly by the same interests, the commission may permit or require the filing of a combined report and such other information as he deems necessary, and **is authorized to impose the tax due under this act as though the combined entire net income was that of one corporation, or to distribute, apportion, or allocate the gross income or deductions between or among such corporations,** if he determines that such consolidation, distribution, apportionment or allocation is necessary **in order to prevent evasion of taxes or clearly to reflect the income of any such corporation."** (Emphasis supplied)

Thus California likewise has recognized the desirability of granting discretionary power in the matter of taxing affiliated corporations upon a combined basis for the purpose of preventing tax evasion and as a means of more clearly arriving at the income of the individual members of the affiliated group.

The Tax Law of Oregon, Oregon Code 1930, Chapter 69, Section 1325, contains the following:

> "Where the tax commission has reason to believe that the true income is not reflected in a return made by a corporation which is affiliated with another or other corporations, within the meaning of this section, it may require separate or consolidated returns from said corporations and apply the tax upon the next (net) income determined therefrom. * * * The corporations which may be joined in a consolidated return shall, for the purpose of this act, be treated as one taxpayer and taxable only upon their consolidated profits properly attributable to the state of Oregon."

Similar provisions are found in the corporation income tax statutes of a number of other states, among which

are Iowa,[13] Montana,[14] North Dakota,[15] South Dakota.[16]

The Congress of the United States has also deemed it advisable to grant discretionary power to the Commissioner of Internal Revenue in the matter of the consolidation of accounts and returns of affiliated corporations.

The Federal Revenue Act of 1926, Section 240, Chapter 27, 44 Stat. 46, Act of February 26, 1926, contains discretionary provisions for consolidation of accounts of related trades and businesses.[17]

The Federal Revenue Act of 1924, Section 240, Chapter 234, 43 Stat. 288, Act of June 2, 1924, contained the same provision.

The discretion of the commissioner in refusing to permit the consolidation of accounts when requested to do so by the taxpayer was challenged in the Federal Courts upon a number of occasions and was sustained in every case.

In the case of **Ellison v. Commissioner of Internal Revenue,** 76 F. (2d) 509, (C. C. A. 2nd) (1935), the court said at page 510:

> "By its express terms this section serves no purpose except when action under it is "necessary in order to make an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses." Whether that is necessary is primarily for the determination of the Commissioner whether he acts

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[13]Code of Iowa 1939, section 6943.069.

[14]Revised Code of Montana 1935, section 2303.1.

[15]Chapter 283, North Dakota 1931 Session Laws.

[16]Code of South Dakota 1939, section 57.2714.

[17]"(d) In any case of two or more related trades or businesses (whether incorporated or unincorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the commissioner may and at the request of the taxpayer shall, if necessary in order to make an accurate **distribution or apportionment** of gains, profits, income, deductions, or capital between or among such related trades or businesses, consolidate the accounts of such related trades or businesses."

sua sponte or is requested to act by a taxpayer. If the commissioner fails to find necessity for action and so refuses a taxpayer's request, his determination is final unless shown to have been arbitrary and contrary to the evidence. See Nowland Realty Co. v. Commissioner (C. C. A.) 47 F. (2d), 1018. It is on a par with other findings of fact."

Other cases sustaining the discretion of the commissioner in respect to the consolidation of accounts are:

Crossett Western Co. v. Commissioner of Internal Revenue, 73 F. (2d) 307;

Nowland Realty Co. v. Commissioner, 47 F. (2d) 1018 (C. C. A. 7th) (1931);

Remco SS. Co. v. Commissioner, 82 F. (2d) 988 (C. C. A. 9th) (1936), Certiorari denied 57 S. Ct. 17, 299 U. S. 55, 81 L. ed. 409.

The above subsection (d) became section 45 of Chapter 852, Act of Congress, May 29, 1928, 45 Stat. 806 when it was amended to read as follows:

"Allocation of Income and Deductions.—In any case of two or more trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such trades or businesses if he determines that such distribution, apportionment, or allocation is necessary **in order to prevent evasion of taxes or clearly to reflect the income of** any of such trades or businesses." (Emphasis supplied)

This provision has been retained as section 45 in every revenue act enacted since 1932.

Under the Federal Revenue Act of 1926, and under other federal revenue acts, discretion was also given to the Commissioner of Internal Revenue in the filing of separate or consolidated returns. Provision was made

that once a corporation had made an election to make return on separate or consolidated basis, the basis for subsequent years might not thereafter be changed without permission granted by the commissioner.

With reference to this provision, the court said in the case of **Lucas, Commissioner of Internal Revenue v. St. Louis National Baseball Club,** 42 F. 2d, 984 (C. C. A. 8th) Decided July 19, 1930, rehearing denied August 23, 1930, certiorari denied 51 S. Ct. 87, 282 U. S. 883, 75 L. ed. 779:

> "No permission to file this consolidated return had been obtained from the Commissioner of Internal Revenue. The Commissioner rejected the consolidated return for the year 1923, on the ground that both corporations had filed separate returns for the year 1922 and had obtained no permission from the Commissioner to make a change."

The discretion of the commissioner of Internal Revenue in this respect was also sustained in the following cases:

Dr. Pepper Bottling Company v. Commissioner of Internal Revenue, 69 F. (2d) 768;

Export Leaf Tobacco v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150; 296 U. S. 627.

T. C. Williams Company v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150; 296 U. S. 627.

Smith Paper Company v. Commissioner of Internal Revenue, 78 F. (2d) 163, Certiorari denied 56 S. Ct. 150. 296 U. S. 627.

In the 1932 Revenue act corporations wishing to avail themselves of the privilege of filing consolidated returns were compelled to pay an additional three-fourths of one per cent tax upon their incomes. In the 1934 Act, this privilege was restricted to railroads and railroad holding companies. In 1938 this privilege was extended

to include street and interurban railway operating and holding companies but was denied to other corporations. This provision was retained in the 1939 Revenue Act. However, as to those corporations still having this privilege, the discretionary power of the Commissioner to grant or refuse permission to change the basis of return from an individual to consolidated and vice versa has been retained in every Revenue Act to date.

Thus both the Federal and State governments have recognized the propriety of granting discretionary power to administrative tax authorities in the matter of the consolidation of accounts and returns of affiliated corporations and their taxation upon a combined basis. In no case has any income tax statute declared, nor has any court construing such a statute ever ruled, that the exercise of discretion by a taxing authority with reference to taxing affiliated corporations on a consolidated basis, or granting permission to consolidate accounts or returns, constituted a penalty.

In this connection it should be kept in mind that the taxation of affiliated corporations by the states is rendered difficult because of the interstate character of many of the corporate transactions. This is a problem which the United States government does not have to contend with except in the case of corporations having international transactions. A discretionary power granted to state tax commissions may well be the most effective means of preventing tax evasion and arriving most accurately at the true income of the affiliated groups of corporations within the taxing state.

We therefore, submit to this court, that the natural permissive interpretation of the word "may" in the second sentence of section 32 (c) of the Minnesota Income Tax Act which would grant the Minnesota Tax Commission discretionary power in the matter of taxing

affiliated corporations upon a consolidated basis, **does not make this section repugnant to the equal protection clause of Section 1 of the Fourteenth Amendment** to the United States Constitution.

The non-federal grounds in these cases are neither adequate nor independent.

1. **The State constitutional questions.** In considering the question of whether or not there is any adequate independent non-federal ground for striking down Section 32 (c) in its permissive form, let us first determine if there is any independent state constitutional ground.

In the decision in the Oliver and Proctor cases, 207 Minn. 630, at page 636, 292 N. W. 407, at pages 410, 411, the court said:

> "Without defining the conditions which the commission must find before it could impose a penalty, the legislature could not, as the state claims, leave the imposition of the penalty to the discretion of the commission. There would be an unconstitutional delegation of legislative powers. A. L. A. Schechter Poultry Corp. v. United States, 295 U. S. 495, 55 S. Ct. 837, 79 L. ed. 1570, 97 A. L. R. 947. There would also be a lack of uniformity which would violate our constitutional requirements (Minn. Const., art. 9, sec. 1, as well as U. S. Const., Amend. XIV) if discrimination resulted. We therefore give the statute an interpretation in harmony with the constitution."

No reason is given by the court for any claim of unconstitutionality under the state constitution except as quoted above. The court's syllabus (No. 3 at page 630) states:

> "It would be an unconstitutional delegation of legislative power to authorize the tax commission in its discretion to impose a penalty without a legislative definition of the conditions which it must find to exist before such penalty could be assessed. And if the imposition of the penalty be left to the uncontrolled discretion of the commission and resulted in

discrimination, it would be a violation of our constitutional uniformity clause and of the XIVth amendment."

The court quoted only one case, **A. L. A. Schechter Poultry Corporation v. United States, supra.** To the state supreme court in the instant cases Section 32 (c) was not a taxing provision but a penalty similar to the penalizing regulation of the N. I. R. A. involved in the Schechter case.

The basic error of the state supreme court on this branch of the case is in holding that Section 32 (c) in the form in which the legislature enacted it imposes a penalty and not a tax and that it is therefore in violation of the Fourteenth Amendment, Section 1. This error manifests itself in various ways but, however stated, the same basic misconception is at the bottom of the court's reasoning.

The same reason, namely, that the discretionary calculation of the tax on affiliated corporations upon a consolidated basis amounts to a discretionary penalty, is the basis of all the court's constitutional objections, state as well as federal.

The same reason is at the basis of the court's statutory interpretation causing it to give an unnatural meaning to the permissive "may" in the disputed sentence as hereinafter pointed out. As we have shown the discretionary use of the combined basis does not penalize but merely serves to enable the Tax Commission to more accurately determine the true taxable income of the corporation in a proper case. Therefore the rationale by which the court arrives at the conclusion that there would be violation of the Fourteenth Amendment, Section 1, if the word "may" be given its natural meaning, fails of support.

This is the same line of reasoning used by the court for the claim that such an interpretation of the word

"may" would be violative of the uniformity clause of the state constitution. It is also the same reasoning assigned for the claim that such an interpretation would violate the state constitutional provision against delegation of legislative powers. Thus the rationale for these state constitutional objections also fail of support.

In this connection we call attention to the fact that the state uniformity clause, Article 9, Section 1 of the Minnesota Constitution, has in a number of cases been held to be identical in scope with the equal protection clause of Section 1 of the Fourteenth Amendment. In **National Tea Company v. Minnesota,** 205 Minn. 433, 286 N. W. 360, the Minnesota Supreme Court discussed not only the equal protection clause of the Fourteenth Amendment but also the uniformity clause which provides "taxes shall be uniform upon the same class of subjects. * * *" The Minnesota court cited **Reed v. Bjornson,** 191 Minn. 254, 253 N. W. 102. In the latter case, 191 Minnesota, at pages 260-261, 253 Northwestern, at page 105, the Minnesota court said:

> "In Lake Superior C. I. Mines v. Lord, 271 U. S. 577, 581, 46 S. Ct. 627, 628, 70 L. ed. 1093, 1101, a tax case, the Supreme Court, construing our constitutional requirement of uniformity, said that "it seems to us sufficiently plain that this provision goes no further than the fourteenth amendment. Consequently, if the legislation under review does not offend that amendment there is no conflict with the state constitution." Of course the proper construction to be given our constitution is not a federal question but one upon which our own views are controlling. Nevertheless we regard the construction thus placed upon it by that high court as entitled to great weight."

This court in **Minnesota v. National Tea Company,** 60 S. Ct. 676, at page 677, 309 U. S. 551, (March 25, 1940), referred to the fact that in **National Tea Co. v. Minnesota, supra,** the Minnesota court said:

> "These provisions of the Federal and State Constitutions imposed identical restrictions upon the legislative power of the state in respect to classification for purposes of taxation."

According to the Minnesota court, the natural permissive interpretation of the word "may" is violative of the Fourteenth Amendment because in its permissive form it provides for the imposition of a penalty without defining the conditions which the commission must find before it could impose a penalty. Therefore, says the court, it is a violation of the "uniformity clause" of the state constitution. Therefore, says the court, it is also an unconstitutional delegation of legislative power.

However, if the natural permissive interpretation of the word "may" does not amount to a grant of power to impose a discretionary penalty, this provision is not violative of the Fourteenth Amendment. Therefore, it is not violative of the "uniformity clause" of the state constitution. Therefore also, it is not an unconstitutional delegation of legislative power.

Thus the rationale for all the constitutional objections, state as well as federal, breaks down when once it is determined that the natural permissive interpretation of the word "may" is not a grant of discretionary power to impose a penalty.

We, therefore, submit that the state constitutional grounds for the decisions of the Minnesota Supreme Court are so interwoven with the federal constitutional ground that they cannot be considered adequate independent grounds for the decisions of the Minnesota court.

2. **Questions of Statutory Construction.** We have noted that the court said "we therefore give the statute an interpretation in harmony with the constitution," 207 Minnesota at page 636, 292 Northwestern at page 411. It is a rule of Minnesota statutory construction that

"if the language of a law is reasonably susceptible of two constructions, one of which will render it unconstitutional and the other not, the former must be adopted though the latter is the **more natural.**" **Dunnell's Minnesota Digest,** Section 8931, citing **State ex rel Decker v. Montague,** 195 Minn. 278, 286, 262 N. W. 684, 688, in which the Minnesota Supreme Court stated the above rule as follows:

> "Under the familiar rule stated in 6 Dunnell, Minn. Dig. (2 ed. and Supps. 1932, 1934) section 8931: 'If the language of a law is reasonably susceptible of two constructions, one of which will render it constitutional and the other not, the former must be adopted though the latter is the **more natural.**'" (Emphasis supplied)

It is further a rule of Minnesota statutory construction that "a statute will not be construed so as to render it unconstitutional unless there is **no reasonable alternative.**" **Dunnell's Minnesota Digest,** Section 8950. (Emphasis supplied)

In support of this statement of the law, the author cites the case of **Johnson Service Company v. Kruse,** 121 Minn. 28, 140 N. W. 118, where the court said at pages 32-33:

> "But the statute cannot properly be given this construction, for such would violate the rule that a statute will not be construed in such a manner as to render it unconstitutional except when there is **no other alternative.**" (Emphasis supplied)

We may, therefore, conclude that the non-constitutional grounds given by the court for its decision are intended as a necessary alternative to an otherwise unconstitutional interpretation of the word "may" in Section 32 (c). Clearly the permissive meaning is a natural one. Only under the compulsion of necessity has the court been driven to a mandatory alternative.

If neither the Fourteenth Amendment, Section 1, nor the state constitutional provisions are obstacles to a permissive interpretation of Section 32 (c), then there is no longer any need to seek an alternative to the natural meaning of the discretionary provision.

Thus the non-constitutional grounds given for the opinion of the court in this case cannot be treated as independent grounds, because they are given as the alternative to an otherwise unconstitutional interpretation of the statute. For, no matter how persuasive or cogent the reasons given by the court for them, it is possible that the court might give even more persuasive and cogent reasons for a natural interpretation of the statute, if it were not deterred therefrom by the fear of unconstitutionality.

With respect to the adequacy and substantiality of the non-constitutional grounds advanced by the court an analysis of the court's opinion shows that the first ground mentioned relates to the alleged Wisconsin history of the Minnesota Act. In 207 Minnesota at page 634, 292 Northwestern at page 410, the court says:

> "It seems obvious that with that litigation in mind the Minnesota legislature attached the last sentence of subd. (c) for the purpose of making the powers and duties of the Minnesota tax commission clear; **that it sought to give the Minnesota commission the power the Wisconsin commission claimed.**" (Emphasis supplied)

We agree with the Minnesota Supreme Court that the Minnesota legislature sought to give the Minnesota Tax Commission the powers that "the Wisconsin Commission claimed." However, it is clear that the Wisconsin Tax Commission never contended for a restriction of its powers. On the contrary it contended for expansion of its powers. What the Wisconsin Commission claimed was discretionary power to tax affiliated corporations

upon a consolidated basis in cases where the facts were similar to those in the Curtis case. **Curtis Company v. Wisconsin Tax Commission,** 214 Wis. 85, 251 N. W. 497, 92 A. L. R. 1065. A careful study of the Wisconsin cases cited by the Minnesota court in its decision makes this very clear.

The second non-constitutional ground given by the court for its decision is contained in the following excerpt from the opinion, 207 Minnesota at page 636, 292 Northwestern at page 410:

> "Moreover where a power is conferred to be exercised for the benefit of the state or a private party the word "may" is to be construed to mean "must" and the statute is mandatory."

The opinion does not state for whose benefit the power was given, whether for the state or for a private party. Nowhere does the court state that the alleged benefit is for a private party. The only alleged benefit pointed out by the court for the state is in the statement that taxation on a combined basis "is normally in the interest of the state," 207 Minnesota at page 635, 292 Northwestern at page 410. The court follows the statement just quoted with a sentence:

> "Where graduated surtaxes are imposed, any other construction of the act would be unfair to the state as permitting what is actually one taxpayer to be divided into several so that a lower rate would be applicable."

The graduated surtaxes imposed upon corporations under Chapter 405 amounted to a maximum of $250 in any one case. Even this small graduated feature of the corporation tax was repealed by the legislature in 1937, Chapter 49, Extra Session Laws Minnesota 1937. This graduated feature was a trifling element in the rate structure. How trifling was the graduated feature of the corporation tax may be shown by the following illustra-

tions. Section 6, of Chapter 405, provides for a graduation in the rate of taxes from 1% for the first $1,000 of taxable income to 5% on all income in excess of $10,000. Under this provision a corporation might save anywhere from nothing to a maximum of $250 by reason of being taxed upon a graduated basis instead of upon a flat rate of 5% on all its taxable income. The effect of this provision standing alone would therefore increase a tax to be paid by an affiliated group of corporations by a sum ranging up to $250 for each member but one of the affiliated group.

Statistics compiled by the United States Treasury Department based upon corporate income tax returns for the years 1909 to 1937[18] show that during this period more than one-half of all corporation income tax returns reported either deficits or no incomes. For the period 1930 to 1937, inclusive, the number of corporation returns reporting either deficits or no income was almost twice, as great as those reporting taxable income.

When taxed upon a combined basis all deficits incurred by members of an affiliated group are offset against the taxable income earned by other members of the group. Consequently, there is every likelihood that deficits incurred by some members of the group would make up for any increase in the tax of the group by reason of the graduated feature of the statute. In the cases here involved under the judgments of the state court as they

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[18]Statistics of income for 1937, part 2. Compiled from corporate income and excess profits returns and personal holding company returns. United States Treasury Department, Bureau of Internal Revenue. When added together the total of corporation returns reporting net income for the period of 1909 to 1937 inclusive is 5,287,059. The total of corporation returns reporting no net income for the same period is 5,985,580. The total of corporation returns reporting net income for the period 1930 to 1937 inclusive is 1,294,271 and the total of corporation returns reporting no net income for the same period is 2,433,807.

now stand, 75 corporations claimed deficits or no incomes and of the remaining five, three denied liability.

Furthermore, Section 32 (c) of the Minnesota Act provides for the exclusion of inter-company dividends from the computation of the taxes of affiliated groups upon a combined basis, as well as for the retention of the individual credit of each member of the group which under the statute amounts to $1000 per corporation. This means that in the exceptional case where all members of the affiliated group are earning a profit so that there is no deficit to offset against taxable income, the state would "normally" still lose revenue when the group is taxed upon a combined basis as compared with calculation on an individual basis by reason of the exclusion of inter-company dividends from the computation of the tax.

For illustration let us take an affiliated group composed of 10 corporations, each of which has earned taxable income in excess of $10,000 exclusive of intercorporate dividends. In such case by reason of the graduated provision standing alone the affiliated group would have its taxes increased by $2250 as compared with taxation on an individual basis, for only one graduation of the corporate income tax would be allowed under the law. However, this would be offset if there were inter-company dividends amounting to $45,000. In such case the saving in taxation in the case of the affiliated group would also equal $2250. If the inter-company dividends amounted to more than $45,000 as would not be unlikely in the case of an affiliated group having a taxable income of $100,000 or more, the affiliated group of corporations would pay less taxes upon a combined basis than upon an individual basis. Therefore it seems reasonable to conclude that it would be a very unusual case where an affiliated group of corporations would pay more taxes

upon a combined basis than upon an individual basis.

No element so trifling and unsubstantial as the graduated feature of the corporation tax could form the basis of the benefit to the state referred to in the court's decision.

We respectfully submit that it is only when Section 32 (c) is given its natural permissive meaning that the provision makes sense. In such case it becomes a sharper and more efficient tool in dealing with intricate corporate combinations, not for the purpose of penalizing them, but for the purpose solely of reaching the true taxable net income of such organizations.

For the sake of brevity we here refer to our jurisdictional statement at page 25, et seq., supra, and ask leave to incorporate the same herein.

Therefore, we respectfully submit that the second sentence of Section 32 (c) which provides for the granting of discretionary power to tax affiliated corporations upon a combined basis, does not violate the equal protection clause of Section 1 of the Fourteenth Amendment.

QUESTION IV

The question is whether or not Section 12, Chapter 405, Laws of Minnesota 1933, which provides for the inclusion of income from federal securities together with income from all other securities, with the sole exception of income from Minnesota state and local securities, in the measure of the Minnesota Corporate Franchise Tax, is repugnant to the immunity of federal securities from state taxation under the Constitution of the United States.

POINT IV.

Relating to inclusion of interest from federal securities in the measure of the Minnesota Corporate Franchise Tax.

The Supreme Court of Minnesota erred in holding that the plaintiff, in its causes of action against defendants Duluth, Missabe and Northern Railway Company and The Duluth and Iron Range Railroad Company, was not entitled to include in their gross income, interest from federal securities.

The Supreme Court of Minnesota erred in holding that the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise Tax, under Section 12 of Chapter 405, Laws Minnesota, 1933, is repugnant to the immunity of federal securities from state taxation under the Constitution of the United States.

POINT IV. SUMMARY

(1) The United States Supreme Court decisions relied upon by the Minnesota court do not support its holding that the inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise tax constitutes "unfriendly discrimination" against United States securities in favor of local securities in "substantial competition" with federal securities.

(2) The Minnesota statute Section 12, places income from federal securities in the same class as income from all other securities, in regard to inclusion in the measure of its corporate franchise tax, with the sole exception of Minnesota state and local obligations.

(3) Statutes giving preferment to state over federal securities in the matter of their inclusion in measures of franchise taxation have been construed as valid in other states.

(4) New York State now has a statute in force giving certain of its bonds a much greater preferment in the field of corporate franchise taxation, than would be their mere exclusion from the measure of such a tax.

(5) Laws of this character have not interfered with the marketing of federal securities in the important state of New York or elsewhere in the United States.

(6) Congress itself has enacted legislation resulting in giving a preferment to state securities over federal securities by making federal securities subject to surtax and excess profits taxation by the United States.

(7) The granting of some additional inducement to investors in the way of tax preferment is justifiable in the case of state and local securities since they are less attractive to purchasers than federal securities.

(8) The Minnesota Corporate Franchise Tax exempts institutional investors which are the most important class of corporate purchasers of both state and Federal securities.

(9) Minnesota has evidenced no hostile intent against the United States government in excluding its own securities from the measure of its corporate franchise tax.

(10) In the cases now before this court, there is no evidence whatsoever that the securities of the State of Minnesota and its local subdivisions are in "substantial competition" with the securities of the federal government.

(11) The United States Supreme Court has held in analogous situations affecting interstate commerce that such matters were properly within the province of the legislative function of the United States government.

POINT IV. ARGUMENT

Whether or not the statute Chapter 405, Section 12 of the Minnesota Corporate Franchise tax, because of its exclusion of income from state and local securities, violates the immunity from taxation of federal securities under the United States Constitution by reason of its inclusion of income from federal securities in the measure of the Minnesota Corporate Franchise Tax.

The Minnesota Supreme Court said in its opinion in the case of **Duluth, Missabe & Northern Railway Co., et al.**, 207 Minn. 618, 626, 7, 292 N. W. 401, 406:

> "* * * the inclusion of income from tax exempt securities as a measure of the tax is objectionable when it evidences an attempt to discriminate against income from a particular source. Miller v. Milwaukee, 272 U. S. 713, 47 S. Ct. 280, 71 L. ed. 487; Schuylkill Trust Co. v. Pennsylvania, 296 U. S. 113, 56 S. Ct. 31, 80 L. ed. 91. The dissent in the latter case said that the discrimination must be either unfriendly in design, or in favor of securities in competition with federal securities included in the tax. It seems, in the instant case, that to allow taxation of federal government securities under subd. (g), would operate not only as a discrimination, but also as an unfriendly one, to the favor of local securities which are in fact in substantial competition with the federal securities. We, therefore, conclude that under any interpretation of subd. (g) income from federal securities should not be included in the measure of the tax on defendant's non-railroad income imposed by c. 405."

An analysis of the cases cited in this opinion shows that neither the Miller case nor the majority or the dissenting opinions in the Schuylkill case bear out this broad conclusion of the court.

The case of **Miller v. Milwaukee, supra,** involved a tax upon corporation dividends in proportion to the percentage of the income of the dividend paying corporation which had escaped taxation under the Wisconsin corporation income tax.

In this case Justice Holmes who wrote the majority opinion, said, at page 715:

> "If the avowed purpose or self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail even if but for its purpose or special operation it would be perfectly good. Under the laws of Wisconsin the income from the United States Bonds may not be the only item exempted from the income tax on corporations, but it certainly is the **most conspicuous instance** of exemption at the present time. * * * A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not **aimed** at them, but it becomes a more serious attack upon their immunity when they are its **obvious aim.**" (Emphasis supplied.)

Justice Holmes' objection to the tax was that it was **aimed principally** at United States securities. The objection was not that any **particular source of income** used to measure the tax was included, (even though that source were interest on United States securities) but simply that the bonds of the United States government were the **principal source** of the income used to measure the tax. There is nothing in this decision which can lend any support to a conclusion that income from federal obligations may not be included in the measure of a tax which also includes income from all other securities with the **sole exception** of income from state securities.

The Schuylkill case cited supra involved a Pennsylvania statute taxing shares of trust companies which excluded from its measure the value of shares of corporations either already taxed or specifically exempted from taxation under the provisions of the Pennsylvania capital stock tax statute.

The objection of the majority of the court to the validity of the tax on trust company shares was that the

sole test used for exclusion from the measure of the tax, depended upon the tax status of the exempted securities under another taxing statute. For this reason it appeared to the majority of the court that Pennsylvania was aiming at the immunity of Federal Securities from taxation rather than attempting to make justifiable exclusions from the measure of the tax. In this case, 296 U. S. 113, the court said at page 120:

> "If the tax is lifted from the shares of certain trust companies because those companies own only stocks **already taxed or relieved from taxation by the state**, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law discriminates in favor of the former against the latter solely by reason of ownership of such federal securities," (Emphasis supplied.)

The majority opinion of the court in this case is therefore no authority for any conclusion as to the invalidity of a taxing statute where the basis of the exclusion of any security from its measure is other than that it is being taxed or exempted from taxation under any other taxing statute. The language used in this decision does not apply to a case where the exclusion is based upon the **ordinary** public policy of a state in exempting its own securities from taxation without any hostile intent against federal securities.

Nor does the dissenting opinion in the Schuylkill case support the Minnesota court in its conclusion. In his dissent at page 128, Justice Cardozo said:

> "Unfriendly discrimination might be inferred if securities of every kind were excluded from the reckoning with the single exception of the obligations of the national government. That would be an extreme case, the conclusion hardly doubtful. Even though hostility were not so pointed as in the case

> supposed, there might still be an invidious distinction if securities in substantial competition evidences of indebtedness issued by the National Government had been given a preferred position. Nothing of the kind appears."

A comparison of the foregoing excerpt from Justice Cardozo's opinion with the opinion of the Minnesota court indicates that the Minnesota court used much the same language in its characterization of the inclusion of federal securities and the exclusion of state securities in the measure of its corporate franchise tax.

However, Justice Cardozo and the Minnesota court differ widely as to the kind of situations to which such language applies. This is demonstrated when, for the purpose of proving that there was no "unfriendly discrimination" in the Schuylkill case, Justice Cardozo continuing with his dissent said at page 129:

> "The situation, there is this: Vast classes of securities, bonds and notes of every kind, as well as shares of stock in many and varied enterprises, are in the same position for the purpose of the tax in suit as government bonds and notes. The few investments that occupy a different position are not comparable in kind or in attractiveness to the obligations of the government, and do not substantially compete with them."

This is the same situation as exists in reference to the Minnesota statute. The only investment that is excluded from the measure of the tax is interest from obligations of the State of Minnesota and its subdivisions. Income from all other securities is included.

What Justice Cardozo meant by "unfriendly discrimination" and "substantial competition" can best be ascertained from the following excerpt from his dissent in which he used as analogy the taxation of national banks, pages 129, 130, 131:

> "The discrimination, as has been said, must be so marked as to justify the inference that it was un-

> friendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities. A helpful analogy is found in the taxation of national banks. * * * Adams v. Nashville, 95 U. S. 19, at page 22, 24 L. ed. 369, 22 Am. Rep. 430, was a case where a municipal ordinance gave exemption from taxation to the municipal bonds. Again the ruling was that this exemption of particular property did not affect the validity of the tax upon the shares. The plain intention of that statute (R. S. §5219 was to protect the corporations formed under its authority from unfriendly discrimination by the states in the exercise of their taxing power." "It was not intended to cut off the power to exempt particular kinds of property if the legislature chose to do so." Id. Mercantile Nat. Bank v. New York, 121 U. S. 138, 30 L. ed 895, 7 S. Ct. 826, was a case where exemption had been given to bonds of municipal corporations and also to deposits in savings banks. Again the protest of discrimination was unavailing to defeat the tax."

Therefore, it is evident that none of the cases cited by the Minnesota court give support to its conclusion that the exclusion of income from obligations of the State of Minnesota and its subdivisions from the measure of the corporation franchise tax is an unfriendly discrimination in favor of local securities which are in substantial competition with federal securities included in the tax.

In regard to the specific question as to the validity of a taxing statute which excludes from the measure of a state franchise tax on corporations state obligations or their income but gives no such exclusion to federal obligations or their income, we have found no federal cases in point. There are, however, a number of state statutes and decisions which are of interest in this connection.

The question of discrimination against the United States by reason of such an exclusion of state obligations from the measure of a tax on national banks was under consideration in 1916 by the South Carolina Su-

preme Court in the case of **Nat. Union Bank of Rock Hill v. Neil,** 106 S. Ct. 173, 182, 90 S. E. 744.

The court said in reference to this matter at page 182:

> "The exemption of State bonds in ascertaining the value of shares in the hands of shareholders of the banks is **not an unlawful discrimination,** either against Federal securities or other state and municipal bonds not so exempted. Chester v. White, 70 S. Car. 433, 50 S. E. 28; Mercantile Bank v. New York, 121 U. S. 138, 7 S. Ct. 826, 30 L. ed. 895." (Emphasis supplied.)

A similar statute of the State of Oklahoma exempting public building bonds of that state from the measure of the tax on national banks was construed in 1924 by the Oklahoma Supreme Court in the case of **In re Assessment of Walters National Bank of Walters,** 100 Okla. 155, 160, 228 P. 953. The court said at page 160:

> "It is therefore concluded that the assessed valuation of the shares of stock in the instant case should have been upon the actual values thereof, less the amount of public building bonds in which the capital of the bank was invested and that in denying the claimed deductions the trial court erred."

Thus the Oklahoma court recognized the validity of an exemption of public building bonds of the State of Oklahoma in a statute taxing national bank shares which gave no such exemption to federal securities.

This position of the Oklahoma court was reaffirmed by it in **Board of Equalization v. Exchange Nat. Bank,** 104 Okla. 92, 230 P. 728.[19]

With reference to the exclusion of income from state obligations from the measure of a corporate franchise tax, which at the same time does not exempt income from federal obligations, there is a noteworthy decision

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[19]The South Carolina and Oklahoma cases here discussed are cited in the annotation to the case of Schuylkill v. Pennsylvania, 81 L. ed. 91, at page 105.

by the New York Court of Appeals construing a New York statute.

In 1917, the legislature of New York State enacted a franchise tax on the ordinary business corporation measured by net income. In the computation of **net income,** "gross income" from which **net income** was defined in the statute as being the same as reported to the United States government by the taxpaying corporation. Under the federal law at that time **gross income** excluded all income from state and local governmental obligations but included income from obligations of the United States government to the extent that they were not exempt from "war profits" taxation in the hands of the taxpayer.

Construed literally, the effect of this provision of the New York law was that in case of those corporations subject to "war profits" taxation, income from these federal obligations was included in the measure of their New York corporation franchise tax, although income from the obligations not only of the State of New York and its subdivisions but also of all other states of the Union and their subdivisions was exempted from the measure of this tax.

The question of the proper construction of this statute was determined by the New York Court of Appeals in the case of **People ex rel Standard Oil Co. of New York v. Law, et al., State Tax Commission,** 142 N. E. 44, 237 N. Y. 142, 143.

In the syllabus of this decision at page 142 is contained the following pronouncement:

> "2. Interest on United States bonds should be included in estimating gross income unless they come within subdivision 4 of section 213b of the federal statutes.
>
> 3. Interest received on tax exempt bonds of the state of New York and political subdivisions thereof

forms no part of gross income and should not be considered."

The Court said in its opinion at pages 149, 150:

"If this is so the result reached below is not wholly correct. As there was included in gross income interest on bonds of the United States and also on bonds of New York and various political subdivisions. **The interest on the United States bonds should have been included** unless they come within the exception mentioned in subdivision 4 of section 213b of the federal statute. It does not appear that they do. **Otherwise as to other interest. It forms no part of gross income and should not be considered.** As to the foreign taxes they were a proper business expense to be deducted from gross to find net income." (Emphasis supplied.)

The language of the decision in this case is broad enough to exclude income from obligations of all other states of the Union and their subdivisions in the measure of the New York corporate franchise tax even though income from certain federal securities were not exempt therefrom.

There does not seem to have been any concern evinced by the United States government or Congress over this preferment given to state and local obligations by this construction of the New York statute. No action was ever taken in any federal court to challenge this preferment of state obligations on the ground that it amounted to "unfriendly discrimination" against the United States in favor of securities in "substantial competition" with federal securities. Nor does it appear that this preferment interfered in any way whatsoever with the marketing of federal securities in the state of New York.

It is noteworthy that Justice Cardozo, then a member of the New York Court of Appeals, was one of the Justices who sat in the consideration of this case. The record shows that he concurred in all respects with this decision including the exemption of income from state

obligations and the inclusion of income from federal obligations in the measure of the New York tax. He merely dissented from that part of the majority opinion excluding foreign taxes paid from gross income in the computation of net income. Thus evidently in 1923, when this decision was rendered, Justice Cardozo who later wrote the dissenting opinion in the Schuylkill case, supra, did not believe that the exclusion of income from state securities from the measure of a corporate franchise tax, which did not also exclude income from federal obligations, constituted an "unfriendly discrimination" against the United States in favor of securities in "substantial competition" with federal securities.

The tax laws of the State of New York even to this day contain a provision giving to certain obligations of the State of New York a far greater preferment over federal securities in the field of corporate franchise taxation, than their mere exclusion from the measure of such a tax.

This provision is contained in section 190 of the Tax Law of New York, Title 59, McKinney's Consolidated Laws of New York, Annotated. It is as follows:

> "§190. PURCHASE OF STATE BONDS: CREDIT TO BE GIVEN
>
> Every corporation, company, association or taxpayer required by section one hundred eighty-seven, section one hundred eighty-nine or article nine-a, nine-b, or nine-c of this chapter to pay a tax which shall own any of the bonds of the state of New York, issued and sold prior to February tenth, nineteen hundred thirty-one, shall have credited to it annually to apply upon or in lieu of the payment of such tax an amount equal to one per centum of the par value of all such bonds of the state, bearing interest at a rate not exceeding three per centum per annum, owned by such corporation, company or association * * *."

In regard to the sections referred to in this provision, section 187 provides for the payment of a franchise tax

by insurance companies measured by a percentage of gross premiums paid by policyholders. Section 189 provides for an annual franchise tax on savings banks equal to six-tenths of one per cent of value or surplus and undivided earnings. Article 9-A provides for a franchise tax on ordinary business corporations based upon net income. The rate of this tax is 4½ per cent with a temporary increase to 6 per cent. Art. 9-B provides for franchise taxes on state banks, trust companies and other financial corporations based on net income at the rate of 4½ per cent plus a franchise tax of one mill on their capital. Article 9-C provides for taxation of national banking association franchises at the rate of 4½ per cent of net income.

Under section 190 of the New York tax law, the credit given to corporations in the payment of their franchise taxes amounts to one per cent of the par value of the New York bonds paying three per cent interest made eligible for this credit. The advantage derived from the mere exclusion from tax of income from a three per cent bond, in the case of a franchise tax of 4½ per cent, amounts to .14 of one per cent of the par value of the bond and, in the case of the temporary six per cent franchise tax to which the ordinary New York corporation is now subject, this advantage would be .18 of one per cent.

Thus the preferment given by this credit provision to those New York state bonds made eligible thereunder ranges from over seven to over five times as great as would be merely their exclusion from the income measure of the corporate franchise tax.

This provision of the New York Tax Law giving a credit to corporations owning certain state bonds, not allowed to corporations owning federal obligations, has been in effect ever since 1907. It has been amended a

number of times in ways not pertinent to this discussion. But in its essential respect, giving a credit to corporations owning New York state bonds not given to owners of federal bonds in corporate franchise taxation, it has been in effect continuously from 1907 to date.

Thus for a period of thirty-three years, the state of New York has been granting certain of its bonds a preferment over federal securities in the matter of franchise taxation many times as great as would be their mere exclusion from the measure of a franchise tax.

Cases involving the New York corporation franchise tax laws have been reviewed by this court in a number of cases. Among them are **Education Films Corp. v. Ward,** 51 S. Ct. 170, 282 U. S. 379, 75 L. ed. 400; also **Bass v. State Tax Commission,** 45 S. Ct. 82, 266 U. S. 271, 69 L. ed. 282. Yet none of the litigants have seen fit to raise the issue of discrimination against federal securities as a defense against the imposition of the New York tax.

New York is recognized as the most important financial state of the Union. If the tax policies of any state could interfere with the fiscal policies of the United States government, it would be those of New York. Yet during all of these thirty-three years, neither Congress nor any other agency of the United States government has ever evinced any concern over this matter. This provision was never thought of as interfering in any way with the marketing of federal securities in the state of New York.

It is clear from their inaction in this and other similar situations, that neither Congress nor the United States government has ever deemed that the exemption of state and local obligations from the measure of a tax, when this exemption was not given to federal securities, constituted an "unfriendly discrimination" against the United States or that such securities were in "substan-

tial competition" with federal securities so as to warrant either court or legislative action.

As a matter of fact, if the exclusion of income from state securities and the inclusion of income from federal securities in the measure of a tax constitutes an "unfriendly discrimination" in favor of local securities in "substantial competition" with federal securities, then Congress itself is also guilty of such a charge.

Congress has by specific legislation with this purpose in mind subjected most federal securities to surtax and excess profits taxation by the federal government, although the income from state and local governmental securities is not subject to such taxes.

Evidently, when it enacted such legislation Congress recognized the fact that the securities of the states and their local governmental subdivisions were not in substantial competition with federal securities. Congress, therefore, must have concluded that legislation having the effect of giving a preferment to state and local securities over federal securities in the matter of taxation would not interfere with the marketing of federal securities.

It is of course well recognized that the obligations of the United States government are far superior generally to state and local obligations in regard to safety and marketability. In reference to the obligations of local governments, the number of defaults in the payment of interest and principal thereon became so great that Congress found it necessary to enact legislation in an effort to deal with this problem.

The securities of state and local governments are also at a disadvantage as compared to federal securities in other ways, such as eligibility for investment by trust funds, and for use in the posting of public bonds, the tests for which they cannot meet as easily as federal securities.

States and their local subdivisions therefore frequently find great difficulty in marketing their securities. Hence, they seek to give investors some additional inducements besides merely a higher rate of interest. The most important of these inducements usually is exemption from taxation. The benefit of such exemption is primarily restricted to the state of issue; for states ordinarily do not exempt from taxation state and local securities other than their own.

From the revenue standpoint, **exemption from direct income taxation** offers no problem. The loss of revenue because of this exemption may be more than compensated for by higher prices and lower interest rates for state and local securities.

However, in the case of corporate franchise taxation a different situation may prevail. Federal securities, which are not subject to direct income and property taxation, may lawfully be included in the measure of a corporate franchise tax. If a state did not have the power to exempt its own securities from the measure of a franchise tax, without at the same time exempting federal securities, it might result in a great loss of revenue to the state, should it attempt to adopt such a policy.

In these difficult times, when the demands upon state treasuries are so great, but few states can afford to risk the loss of revenue which such a policy might entail, should the exemption of state obligations from franchise taxation have to be accomplished by a like exemption of federal obligations. If this were the law, it would effectively deter the various states from exempting their own and local governmental securities from measures of corporate franchise taxation. Thereby it would greatly restrict the states in their policy of exempting their own and local governmental securities from taxation, a policy which has always been considered lawful and proper.

The 1933 Minnesota Corporate franchise tax law is limited in scope. National and state banks, insurance companies and other institutional investors are exempted from the tax under the provisions of section 5 of the Act. It is the institutional investors that form the principal market for federal and state securities among corporations. The ordinary business corporation to whom this act applies has very little occasion for the purchase of such securities. Whatever surplus funds it has on hand are there but temporarily. They are held for use in the usual course of the business of the corporation. Such corporations cannot compete with financial institutions in the purchase of short term federal obligations as a temporary investment for surplus funds. These have now for a long time been selling at rates to yield less than one per cent per annum, which would hardly cover the overhead cost of making such a temporary investment by the ordinary business corporation.

The securities of the State of Minnesota and its local subdivisions can therefore, in no sense of the word, be said to compete with federal securities in the field of investment that is open to the ordinary business corporation to which the Minnesota corporate franchise tax principally applies.

It is, of course, clear that the State of Minnesota had no hostile intent against the United States when it exempted its own securities from the corporation franchise tax without at the same time exempting federal securities. Such a claim is patently absurd. Neither is there any serious competition between the obligations of the State of Minnesota and its local subdivisions and federal obligations. The granting of this exemption has in no way interfered with the marketing of federal securities in the State of Minnesota. The Minnesota corporate franchise tax has been in force since 1933. The decision of

the Minnesota Supreme Court to the effect that the inclusion of income from federal securities was invalid was rendered in December, 1939, over six years since the enactment of the law. Neither Congress nor the United States government have ever evinced any concern over this situation during this six-year period. This issue has only been raised by private interests in an effort to escape taxation.

In the cases now before this Court, there is no evidence whatsoever that the Securities of the State of Minnesota and its local subdivisions are in "substantial competition" with the securities of the federal government.

That the Minnesota Corporate Franchise Tax Law was enacted in the pursuit of ordinary public policy and is not an unfriendly discrimination against the United States is unquestionable. That this Act has in no way interfered with the marketing of Federal securities in the State of Minnesota is also unquestionable. The only question that might be raised is that the exclusion of interest from state and local obligations of the State of Minnesota, not allowed to interest from federal securities, may at some future time slightly interfere with the marketing of federal securities.

In answer, we point to the decisions of this court in similar situations involving alleged interference with Interstate Commerce. **Milk Control Board v. Eisenberg Farm Products**, 306 U. S. 346, 351, 352, 59 S. Ct. 528, 83 L. ed. 752. This court said:

> "Every state police statute necessarily will affect interstate commerce in some degree, but such a statute does not run counter to the grant of Congressional power merely because it incidentally or indirectly involves or burdens interstate commerce. This is so even though, should Congress determine to exercise its paramount power, the state law might thereby be restricted in operation or rendered unenforceable."

Situations of this sort are within the province of the **legislative function** as distinguished from the **judicial function** of the federal government.

As this court said in **South Carolina State Highway Department v. Barnwell Bros.,** 303 U. S. 177, 184, 185, 58 S. Ct. 510, 82 L. ed. 734:

> "Congress in the exercise of its plenary power to regulate interstate commerce, may determine whether the burdens imposed on it by state regulation, otherwise permissible, are too great, and may by **legislation** designed to secure uniformity or in other respects to protect the national interest in the commerce, curtail to some extent the state's regulatory power. But that is a **legislative,** not a **judicial,** function, to be performed in the light of the Congressional judgment of what is appropriate regulation of interstate commerce and the **extent** to which in that field, state power and local interests should be required to yield to the national authority and interest. In the absence of such legislation, the **judicial function,** under the commerce clause, Const. Art. 1, §8, cl. 3, as well as the Fourteenth Amendment, **stops** with the inquiry whether the state legislature in adopting regulations such as the present has acted within its province, and whether the means of regulation chosen are reasonably adapted to the end sought." (Emphasis supplied.)

We represent to the court that any casual interference with the marketing of federal securities that might at some future time result from this provision of the Minnesota Act is also within the province of the **legislative function** of the Federal government, and not of its **judicial function.**

In conclusion, we therefore respectfully submit to this court that subdivision (7) of Section 12 of the Minnesota Act, limiting the exclusion from the Minnesota tax on corporate franchises to income from obligations of the State of Minnesota and its governmental subdivisions, is not invalid as violative of the United States Constitution.

CONCLUSION

For the foregoing reasons, we respectfully submit that this court should grant writs of certiorari to review the final judgments herein of the Supreme Court of the State of Minnesota in each of the above entitled actions.

Respectfully submitted,

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APPENDIX.

EXHIBIT A.

Chapter 405, Laws of Minnesota 1933.

(Title of the Act)

"An act raising revenues, imposing income taxes and franchise or privilege taxes measured by income, providing certain exemptions and exceptions from such taxes, providing for the assessment, levy and collection thereof, and the distribution of the proceeds therefrom, appropriating money for the administration thereof, providing penalties for violations thereof and defining certain crimes in connection therewith and imposing penalties therefor."

* * * * *

Article II. Imposition of Taxes.

"Sec. 2. Income Tax Imposed.—There is hereby imposed on every domestic and foreign corporation an annual tax for the privilege of existing as a corporation or of transacting any local business within this state during any part of its taxable year, measured by its taxable net income for such year, computed in the manner and at the rates hereinafter provided."

Sec. 3. (a) There is hereby imposed an annual tax for each taxable year upon the taxable net income for such year of every taxpayer specified in sub-section (b) hereof, computed in the manner and at the rates hereinafter provided.

(b) The tax imposed by sub-section (a) shall apply in the case of a domestic and foreign corporation whose business within this state during any taxable year consists exclusively of interstate commerce; to resident and non-resident individuals; to the estates of decedents dying domiciled within or without this state; to trusts (except so far as these are taxable as corporations) however created by residents or non-residents or by domestic or foreign corporations; provided that no non-resident individual shall be taxed on his income from compensation for labor or personal service within this state during any taxable year unless he shall have been engaged

in work within this state for more than 150 working days during such taxable year.

* * * * *

"Sec. 5. Exemptions from Act.—The following corporations and organizations shall be exempted from taxation under this Act:

(a) National and state banks.

(b) Corporations engaged in the business of mining or producing iron ore; but if any such corporation engages in any other business or activity or has income from any property not used in such business it shall be subject to this tax computed on the net income from such property or such other business or activity. Royalty (as defined in Mason's Minnesota Statutes of 1937, Section 2392-2) shall not be considered as income from the business of mining or producing iron ore within the meaning of this section.

(c) Insurance companies, however, or wherever organized, and regardless of the risks insured against.

(d) Fraternal beneficiary associations wherever organized, and public department relief associations of public employees of this State or of any of its political subdivisions.

(e) Co-operative or mutual rural telephone associations.

(f) Corporations engaged in the business of loaning money to home builders for home building purposes, but if any such corporation is engaged in any other business or activity or has income from any property not used in such business it shall be subject to this tax computed on the net income from such property or other business or activity.

(g) Labor, agricultural and horticultural organizations, no part of the net income of which inures to the benefit of any private member, stockholder, or individual.

(h) Farmers, fruit growers, and like organizations organized and operated as sales agents for the purpose of marketing products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity or value of produce furnished by them; and farmers' co-operative associations, however organized, so far as engaged in marketing farm products, or in buying and selling farm products and supplies without profit, and co-operative associations organized under the laws of this state in good faith and not for the purpose or with the intent of evading the tax hereby imposed.

(i) Corporations operating or conducting public burying grounds, public school houses, public hospitals, academies, colleges, universities, seminaries of learning, churches, houses of worship, and institutions of purely public charity, no part of the net income of which inures to the benefit of any private member, stockholder, or individual.

(j) Corporations organized for exclusively scientific, literary or artistic purposes, no part of the net income of which inures to the benefit of any private member, stockholder, or individual.

(k) Business leagues and commercial clubs, not organized for profit and no part of the net income of which inures to the benefit of any private member, stockholder or individual.

(l) Clubs organized and operated exclusively for pleasure, recreation or other nonprofitable purposes, no part of the net income of which inures to the benefit of any private member, stockholder or individual;

(m) Any corporation all the stock of which is owned by the United States or which may be exempt from a state franchise or income tax by federal law.

(n) The State of Minnesota and all its political or governmental subdivisions, municipalities, agencies, or instrumentalities, whether engaged in the discharge of governmental or proprietary functions."

* * * * *

Sec. 8. The tax for the first taxable year in the case of taxpayers taxable under Section 2 whose taxable year ended prior to the date on which this Act takes effect shall be a tax directly on its taxable net income instead of on the exercise of the privileges specified in said Section during such first taxable year."

* * * * *

Article III. Computation of Net Income.

* * * * *

"Sec. 11. What is Gross Income.—The term "gross income" shall include every kind of compensation for labor or personal services of every kind from any private or public employment, office, position or services, whatsoever; income derived from the ownership or use of property; gains or profits derived from every kind of disposition of, or every kind of dealings in, property; income derived from the transaction of any trade or business; and income derived from any source whatever. Items of gross income includible within said definition shall be deemed such regardless of the form in which received. Items of gross income shall be included in gross income of the taxable year in which received by a taxpayer unless properly to be accounted for as of a different taxable year under methods of accounting permitted by Section 9, except that (1) amounts transferred from a reserve or other account, if in effect transfers to surplus, shall, to the extent that such amounts were accumulated through deductions from gross income during any taxable year, be treated as gross income for the year in which the transfer occurs, and (2) amounts received as refunds on account of taxes deducted from gross income during any taxable year shall be treated as gross income for the year in which actually received.

Sec. 12. Exemptions from Gross Income.—The following items shall not be included in gross income:

(a) The value of property acquired by gift, devise, bequest or inheritance, but the income from such property shall be included in gross income; the income received under a gift, devise, bequest or inheritance of a right to receive income shall also be included in gross income.

(b) Amounts received under a life insurance contract payable by reason of the death of the insured, whether in a single sum or in installments; but the interest accruing after December 31, 1932, and paid by the insurer on any such amounts held by it after the death of the insured shall be included in gross income.

(c) Amounts received, other than those specified in subdivision (b), under a life insurance, endowment, or annuity contract; but if such amounts when added to the amounts received under such contract before the taxable year (after deducting from the aggregate of amounts received such proportion thereof as is represented by interest accrued prior to January 1, 1933) exceed the aggregate premiums or consideration paid, whether or not paid during the taxable year, then the excess shall be included in gross income. The amount which a transferee for a valuable consideration of any such contract, or interest therein, shall be permitted to exclude from his gross income shall be the actual value of the consideration paid by him plus the amount of the premiums and other sums subsequently paid by him thereunder.

(d) Amounts received as compensation for personal injuries or sickness by the injured or sick taxpayer, whether received under accident or health insurance contracts, workmen's compensation acts, any plan maintained by employers for such purpose, or by way of damages received in any suit or by agreement; also amounts received as compensation for the death of any member of the taxpayer's family, whether received under insurance contracts, workmen's compensation acts, any plan maintained by employers for such purposes, or by way of damages received in a suit or by agreement; and amounts received under any arrangement entered into by the taxpayer to provide a fund specifically intended to defray the funeral expenses of himself or any member of his family. The words "compensation" and "damages" as used in this subdivision shall include reimbursement for medical, hospital and funeral expenses in connection with such sickness, injury or death.

(e) Amounts received by any person from the United States or the State of Minnesota by way of a pension, family allotment, or other similar allowance.

(f) Interest upon obligations of the State of Minnesota, any of its political or governmental subdivisions, any of its municipalities, or any of its governmental agencies or instrumentalities.

(g) Income received from the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law.

(h) The rental value of the premises occupied by the taxpayer as his home, or for his business, except where the occupancy by such taxpayer of such premises for such purposes constitute in whole or in part the consideration received by him in connection with a transaction such that, had such consideration been received thereunder in cash or other property, the amount thereof would have been required, either in whole or in part, to be included in his gross income.

(i) The value of food and goods produced by the taxpayer and consumed or used by his immediate family.

(j) Amounts deducted from the wages or salaries of employees by employers under a voluntary or compulsory plan of unemployment insurance shall not be included in the gross income of such employees.

(k) The amounts distributed by co-operative buying, selling or producing associations, however organized, as patronage dividends shall not be included in the gross income of such associations.

(*l*) Subdivisions (c), (d), (i) and (j) shall not apply to corporations, and subdivision (g) shall not apply to corporations taxable under Section 2, except so far as taxable under Section 8."

* * * * *

Sec. 27. Personal credits on income. The taxes imposed by this Act shall be on, or measured by, as

the case may be, the taxable net income less the following credits against it:

* * * * *

(e) A credit of $1,000 in the case of each corporation.

* * * * *

Article IV. Provisions Relating to Special Cases.

* * * * *

"Sec. 32. Special Taxes for Corporation.—(a) If a corporation is formed or availed of for the purpose of splitting up the income of its stockholders, or of the holders of a majority of its shares, with an aim to reducing the total amount of their taxes under this Act, there shall be imposed upon it a special tax, in addition to those otherwise imposed by this Act, of ten per cent of its taxable net income assignable to this state less credits against net income under Section 27.

(b) When any corporation liable to taxation under this Act conducts its business in such a manner as either directly or indirectly to benefit its members or stockholders or any person or corporation interested in such business or to reduce the income attributable to this state by selling the commodities or services in which it deals at less than the fair price which might be obtained therefor, or buying such commodities or services at more than the fair price for which they might have been obtained, or when any corporation, a substantial portion of whose shares is owned, directly or indirectly, by another corporation, deals in the commodities or services of the latter corporation in such a manner as to create a loss or improper net income or to reduce the taxable net income attributable to this state, the Commission may determine the amount of its income so as to reflect what would have been its reasonable taxable net income but for the arrangements causing the understatement of its taxable net income or the overstatement of its losses, having regard to the fair profits which, but for any agreement, arrangement, or understanding might have been or could have been obtained from such business.

(c) Whenever a corporation which is required to file an income tax return is affiliated with or related

to any other corporation through stock ownership by the same interests or as parent or subsidiary corporations, or has its income regulated through contract or other arrangement, the Tax Commission may permit or require such consolidated statements as in its opinion are necessary in order to determine the taxable net income received by any one of the affiliated or related corporations. If 90% of all the voting stock of two or more corporations is owned by or under the legally enforceable control of the same interests the Commission may impose the tax as though the combined entire taxable net income was that of one corporation except that the credit provided by Section 27 (e) shall be allowed for each corporation; but inter-company dividends shall in that event be excluded in computing taxable net income."

* * * * *

Approved April 21, 1933.

EXHIBIT B

Act of Congress of February 28, 1920 "Transportation Act 1920", 41 Stat. 488, Ch. 91, Sec. 422, Title 49 U. S. C. A. Section 15a:

"* * *

Subsection 5. Amounts received by carriers in excess of fair return payable to United States.—Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is declared that any carrier which receives such an income so in excess of a fair return, **shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to the United States.**

Subsection 6. **Disposition of amounts received in excess of 6 per centum.**—If, under the provisions of this section, any carrier received for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, **one-half of such excess shall be placed in a reserve fund** established and maintained by such carrier, **and the remaining one-half thereof shall, within the first four months following the close of the period for which such computation is made, be recoverable by and paid to the commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described.** For the purposes of this paragraph the value of the railway property and the net railway operating income of a group of carriers, which the commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system.The value of such railway property shall be determined by the commission in the manner provided in paragraph (4).

* * * * *

Subsection 10. **General railroad contingent fund, use and disposition.** – The general railroad contingent fund so to be recoverable by and paid to the commission and all accretions thereof shall be a revolving fund and shall be administered by the commission. It shall be used by the commission in furtherance of the public interest in railways transportation either by making loans to carriers to meet expenditures for capital account or to refund maturing securities originally issued for capital account or by purchasing transportation equipment and facilities and leasing the same to carriers, as hereinafter provided. Any moneys in the fund not so employed shall be invested in obligations of the United States or deposited in authorized depositaries of the United States subject to the rules promulgated from time to time by the Secretary of the Treasury relating to Government deposits."

EXHIBIT C.

Act of Congress of June 16, 1933 "Emergency Railroad Transportation Act, 1933", 48 Stat. 220, Ch. 91, Tit. II, Sec. 206, Title 49 U. S. C. A., Section 15 b:

"Sec. 15b. Collection of excess income discontinued; general railroad contingent fund liquidated; distribution of moneys; computation of tax liabilities."

"(a) All moneys which were recoverable by and payable to the Interstate Commerce Commission, under paragraph (6) of section 15a of this chapter, as in force prior to June 16, 1933, shall cease to be so recoverable and payable; and all proceedings pending for the recovery of any such moneys shall be terminated. The general railroad contingent fund established under such section shall be liquidated and the Secretary of the Treasury shall distribute the moneys in such fund among the carriers which have made payments under such section, so that each such carrier shall receive an amount bearing the same ratio to the total amount in such fund that the total of amounts paid under such section by such carriers bears to the total of amounts paid under such section by all carriers; except that if the total amount in such fund exceeds the total of amounts paid under such section by all carriers such excess shall be distributed among such carriers upon the basis of the average rate of earnings (as determined by the Secretary of the Treasury) on the investment of the moneys in such fund and differences in dates of payments by such carriers."

"(b) * * *. All distributions made to carriers in accordance with subdivision (a) of this section shall be included in the gross income of the carriers for the taxable period in which this section is enacted. * * *".

In the Supreme Court of the United States

October Term A. D. 1940

NO. 539

STATE OF MINNESOTA, Petitioner,

vs.

DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY, and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO. 540

STATE OF MINNESOTA, Petitioner,

vs.

THE DULUTH AND IRON RANGE RAIL ROAD COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO. 541

STATE OF MINNESOTA, Petitioner,

vs.

SPIRIT LAKE TRANSFER RAILWAY COMPANY and Duluth, Missabe and Iron Range Railway Company, Respondents.

NO. 542

STATE OF MINNESOTA, Petitioner,

vs.

OLIVER IRON MINING COMPANY, Respondent.

NO. 543

STATE OF MINNESOTA, Petitioner,

vs.

PROCTOR WATER & LIGHT COMPANY, Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

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SUBJECT INDEX

TABLE OF CASES CITED

TABLE OF STATUTES CITED

TABLE OF OTHER REFERENCES

In the Supreme Court of the United States

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NO. 539

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vs.

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STATE OF MINNESOTA,

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vs.

PROCTOR WATER & LIGHT COMPANY

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

For the convenience of the court we shall reply to the points in respondents' opposing brief in the order in which they are there treated.

POINT I.

Relating to the payment of the sum of $7,774,804.19 by the United States to defendant Duluth, Missabe and Northern Railway Company in 1933, pursuant to the Act of Congress of June 16, 1933.

The Minnesota Supreme Court in its decisions herein has divided all income received by railroad corporations into two categories:

1. Railroad income which **is not** to be included in the measure of its tax under the Minnesota Corporate Franchise Tax statute.
2. Non-railroad income which **is** to be included in the measure of this tax.

The State Court has placed the sum of $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States under the provisions of the Act of Congress of June 16, 1933 in the category of railroad income. Hence, the State Court has held that this sum was not to be included in the measure of said defendant's tax under the Minnesota Corporate Franchise Tax Statute.

In the State's Petition for Writ of Certiorari and Brief in Support thereof (pp. 12-25, 46-60), it was pointed out that in placing this sum in the category of railroad income, the State Court had misconstrued the Act of Congress of Feb. 28, 1920, considered by this Court in the case of Dayton-Goose Creek Railroad Company vs. United States 263 U. S. 456, 44 S. Ct. 169, 68 L. ed. 388, which originally established the "Railroad Contingent

Fund" and the Act of Congress of June 16, 1933 under the provisions of which this sum was received by said defendant.

It was further pointed out that under the provisions of the Act of Congress of June 16, 1933, it was not necessary for the recipient of any payments thereunder to either own or operate a railroad, or to engage in any distinctive railroad activity whatsoever. In fact, it was not necessary for the recipient to even to be a railroad corporation as distinguished from any other kind of corporation, or even to possess the power to engage in the railroad business at the time of the enactment of this Act of Congress of June 16, 1933 or at any time thereafter.

Therefore, under the proper construction of these Acts of Congress, this sum of $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States should have been placed in the category of non-railroad income.

However, respondents do not merely claim this sum to be railroad income, but they also go further and contend that the decisions of the State Court on this point did not involve or depend upon a construction of any Acts of Congress.

Respondents in their opposing brief have treated the receipt by defendant Duluth, Missabe and Northern Railway Company from the United States in 1933 of the sum of $7,774,804.19 as if that part of the opinion of the State Court dated April 26, 1940 relating to this subject stood alone and had no connection whatsoever with its opinion of December 29, 1939. However, in its earlier opinion the State Court considered and gave its views in reference to the taxability under the Minnesota statute of the sum of $5,808,256.61 constituting the major

part of this sum thus received from the United States. The Court said (R. p. 1637; 207 Minn. 618, 625, 292 N. W. 401, 405):

> "The state lists in its brief a number of items which it claims to be "non-operating income," intending thereby to challenge the income therefrom as not properly earnings which result from railroad ownership or operation. Included in this list are the so-called "recapture" fund **returned by the United States government to the railroads by act of Congress, 48 Stat. 220.** The United States under the transportation act of 1920, 41 Stat. 448, took one-half the net earnings of railroads over and above six per cent and held such sums for railroad transportation purposes. Defendants at the time paid taxes on their property measured by all their gross earnings including these funds and paid these funds to the government partly in cash and partly in Liberty bonds. Can the return of these deposits by the government together with interest and accretions be deemed non-railroad income for 1933 and as such taxable under c. 405? It seems clear that the original deposits were railroad income subject to the gross earning tax and upon which such tax was paid. Therefore such returned funds cannot be considered non-railroad income under c. 405, §2. **The repayment amounts to nothing more than the return to defendant of their own railroad earnings. The restoration reinstated the earnings in their original status.** The fund, then, having been taken in the first instance for railroad purposes, held by the government for such purposes, and returned to the companies for railroad purposes are not taxable under c. 405. We need not decide

whether the accretions and interest are taxable items because the combined net loss reported is sufficient to absorb both items as well (fol. 1650) as some others subsequently discussed. The act of Congress providing for the repayment of these recaptured funds, 48 Stat. 220, expressly required that such repayments should be subject to federal income taxes. The board of tax appeals cases cited by the state are therefore not authority here." (Emphasis supplied.)

In this later opinion, the State Court stated that it still adhered to the views it had expressed in its earlier opinion. The court said (R. p. 1816; 207 Minn. 637, 638, 292 N. W. 411, 412, 413):

"Due to the fact that in our original opinion State v. D. M. & N. Ry. Co., — Minn. —, — N. W. — We did not adopt in toto either the theory of the state or that the defendants nor yet that of the trial court, we were reluctant to pass upon certain features which would have been more fully pre sented to us had counsel been aware of **our views on the principal questions involved and to which we now adhere.** (Emphasis supplied.)

We may therefore conclude that the Minnesota Supreme Court has held and still adheres to its opinion that the major portion of the sum of money received by defendant Duluth, Missabe and Northern Railway from the United States was not **non-railroad income for the year 1933.** because it was a restoration reinstating the **earnings** of the recipient to their original status as railroad income for the years in which they were originally earned and upon which the gross earnings tax had been paid in prior years.

We may also conclude that in the opinion of the State Court the so-called "accretions" amounting to $1,966.546.58, which is a part of said sum of $7,774,804.19 received by defendant Duluth, Missabe Northern Railroad Company from the United States, are considered as merely being accretions to earnings of said defendant restored to their original status as railroad income for the years in which they were originally earned.

It is to be noted that nowhere in its opinion of Dec. 29, 1939 did the State Court say that this receipt from the United States constituted **railroad income for the year 1933.** All that the State Court decided is that it was not non-railroad income for 1933, because it was railroad income for prior years reinstated to their original status.

As far as the year 1933 is concerned, the State Court has in effect held that this payment by the United States was merely a receipt of money in 1933; that it **did not constitute either railroad or non-railroad income for 1933;** that this receipt was but a returning and restoration of railroad income for years previous to 1933.

This is a clear misconstruction of the Act of Congress of June 16, 1933, under the provisions of which the sum of $7,774,804.19 was received from the United States by said defendant. This Act in the most unmistakable language specifically states that all monies received under this act **shall constitute income for the year in which it was received from the United States and shall not constitute income for the years in which the payments were originally made to the United States.** This is found in the following provision of the Act. (Act of Congress of June 16, 1933, "Emergency Railroad Transportation Act, 1933", 48 Stat. 220, Ch. 91, Title II, Sec. 206, Title 49 U. S. C. A. Section 15b):

"(b) The income, war profits, and excess-profits tax liabilities for any taxable period ending after Feb. 28, 1920, of the carriers or corporations whose income, war profits, or excess-profits tax liabilities were affected by section 15a of the Interstate Commerce Act, as in force prior to the enactment of this act, shall be computed as if such section had never been enacted, except that, in the case of carriers or corporations which have made payments under paragraph (6) of such section, an amount equal to such payments shall be **excluded from gross income for the taxable periods with respect to which they are made.** All distributions made to carriers in accordance with subdivision (a) of this section shall be **included in the gross income of the carriers for the taxable period in which this Act was enacted."** (Emphasis supplied.)

Thus the decisions of the State Court to the effect that the sum of $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States in 1933 could not be included in the measure of its corporate franchise tax, because this receipt was not non-railroad income for 1933, but was railroad income for previous years and "accretions" thereto, are erroneous. They are based upon a palpable misconstruction of an Act of Congress. Hence these decisions should not stand.

Respondents, in their opposing brief contend that the State of Minnesota was given no right to tax the sum of $7,774,804.19 received by defendant Duluth, Missabe and Northern Railway Company from the United States, under the Acts of Congress by virtue of which this sum was received by said defendant.

Thus respondents, in effect, urge that before any "title, right, privilege or immunity" can be claimed "under the Constitution, or any treaty or statute of, or commission held or authority exercised under, the "United States", it is necessary that such title, right or privilege or authority be specifically set forth in so many words in the Constitution, treaty or statute of the United States.

Respondents have presented no authorities in support of this novel contention. Nor do we know of any case where so narrow a construction has been placed by this Court upon the titles, rights, privileges or immunities which may be claimed under the Constitution, treaties or statutes of the United States.

We know of no case where this Court has not upheld all titles, rights, privileges or immunities which follow from a correct construction of the Constitution, treaties or statutes of the United States; even though they may not have been specifically set forth or enumerated therein.

It is the contention of the petitioner in the instant cases, that under a correct construction of the Acts of Congress, the sum of $7,774,804.19 received by defendant, Duluth, Missabe and Northern Railway Company from the United States in 1933, is subject to inclusion in the measure of said defendant's tax under the Minnesota corporate franchise tax statute.

Therefore, we respectfully submit that by reason of the misconstruction of said Acts of Congress, the State of Minnesota, petitioner herein, has been deprived of its rights arising from said Acts of Congress.

The defendant Duluth, Missabe and Northern Railway Company, by its own volition and accord, has itself raised the question as to the right of the State of Minne-

sota to include this sum received from the United States in the measure of its tax by reason of its having been received under the provisions of an Act of Congress. This is set forth in paragraph 10 of said defendant's Answer to plaintiff's Amended Statement (R. p. 43) and its Answer (Substituted) (R. p. 293) which states the following:

> 10. "Alleges that the item "Refund of Recapture Payments" amount to $5,808,256.61 and the item "Accretions to Recapture Fund" amounting to $1,817,163.53 together with an additional item of $149,384.06 being accretions to the Recapture Fund in 1933 erroneously reported by the defendant as taxable income, under the caption "Gross Income" in said Exhibit "A" represent moneys received by the taxpayer from the United States Government under the provisions of the Act of Congress of June 16, 1933, being chapter 91, Title II, Section 206, 48 Stat. 220; that such moneys to not constitute income of this defendant taxable under the Minnesota State Income Tax Act among other reasons because they constitute a gift from the United States Government, an instrumentality of the United States Government and/or **income earned by the taxpayer in previous years".** (Emphasis supplied.)

Thus said defendant specifically requested that under the provisions of the Act of Congress, the sum of $7,774,804.19 that it had received from the United States in 1933 be construed as a gift from the United States "and/or **income earned by the taxpayer in previous years".**

In response to this specific request, the State Court did give to the provision of the Act of Congress under which this sum was received by defendant one of the alternative constructions that it had requested, viz:—that this receipt of money from the United States was **"Income earned by the taxpayer in previous years."**

This issue was fully litigated in the lower state court. Under the provisions of the Minnesota Statute pertaining to actions for the collection of the corporate franchise tax, no reply was necessary in order to litigate all the issues raised in defendant's answer. [1]

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[1] Chapter 405 of the Laws of Minnesota, 1933 contains the following provisions in section 45 thereof.

> "45. Action for collection of tax. (a) A tax imposed by this Act, including penalties therein, or any portion of such tax, is not paid within 30 days after it is required to be paid hereunder, the Commission shall, unless it proceeds under the provisions of subdivision (b) hereof, bring against the person liable for payment thereof an action at law in the name of the state for the recovery of the tax and interest and penalties due in respect thereof under this act. * * * Such action shall be commenced by filing with the clerk of such Court a statement showing the name and address of the taxpayer, if known, an itemized summary of the taxable net income on the basis of which the tax has been computed, the tax due and unpaid thereon and the interest and penalties due with respect thereto under the provisions of this Act, and shall contain a prayer that the Court adjudge the taxpayer to be indebted on account of such taxes interest and penalties in the amount thereof specified in the statement; a copy of such statement shall be furnished to the clerk therewith. * * * If an answer is filed, the issues raised shall stand for trial as soon as possible after the filing of such answer and the court shall determine the issues and direct judgment accordingly, * * *".

Thus we have a clear cut federal question at issue between the State of Minnesota and said defendant. The State, on one hand, contended that it had the right to include this receipt from the United States by defendant, under a proper construction of the Act of Congress by virtue of which it was received by defendant. On the other hand, defendant contended that under a correct construction of this Act of Congress, this sum could not be included in the measure of its tax.

The State Court decided this issue in favor of defendant by construing the Act of Congress so as to determine the sum thus received from the United States to be **"income earned by defendant in previous years."**

This issue was not merely raised in the State Courts, both District and Supreme, but even in the proceedings before the Minnesota Tax Commission prior to the commencement of the State's actions, which were admitted in evidence in the trial of the case in the lower state Court. (See R. pp. 118, 127, 128, 331, 222, 223, 233, 234.)

Therefore, we submit that the right of the State of Minnesota to tax this sum of $7,774,804.19 received by defendant from the United States following a proper construction of the Act of Congress under the provisions of which it was received, were not merely **either** raised by the State **or** considered by the State Court in its opinion (which is all that is necessary to give this court jurisdiction) [2], but was **both** claimed by the state at all stages of this litigation **and** considered by the State Court in its opinion.

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[2] See San Jose Land, etc. Co. v. San Jose Ranch Co., (Cal. 1903) 189 U. S. 177, 23 S. Ct. 487, 47 L. ed. 765; Mallinckrodt Chemical Works v. Missouri, (Mo. 1915) 238 U. S. 41, 35 S. Ct. 671, 59 L. ed. 1192; Cissona v. Tennessee, (Tenn. 1918) 246 U. S. 289, 38

(Footnote continued on following page.)

POINT II.

Relating to the Taxation of Affiliated Corporations upon a consolidated basis.

Respondents in an effort to show that the non-constitutional grounds advanced in the opinion of the State Court are independent and adequate non-federal grounds for its decision in the Oliver case have endeavored to attach some significance to the larger amount of space devoted to them in the State Court's opinion than to the constitutional grounds (R. pp. 1641-6, State of Minnesota v. Oliver Iron Mining Co., 207 Minn. 630, 292 N. W. 411). An analysis of the opinion of the State Court from this standpoint is therefore in order.

The greater portion of the State Court's opinion in this case, after several introductory paragraphs, is taken up with an attempt to trace the legislative history of this section of the Minnesota statute to a Wisconsin statute (R. pp. 1642-4, 207 Minn. 630, 632-4, 292 N. W. 407, 408-10). Any attempt to trace the legislative history of a statutory provision must of necessity require much space in an opinion. This could not have been avoided once the State Court had undertaken this chore. Surely, this circumstance cannot in any way add to the stature of this portion of the State Court's opinion from the standpoint of independence and adequacy as a non-federal ground.

The conclusion arrived at by the State Court as the result of this, was that the Minnesota legislature gave to the Minnesota Tax Commission the power the Wis-

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S. Ct. 306, 62 L. ed. 720; International Harvester Co. v. Missouri, (Mo. 1914) 234 U. S. 199, 34 S. Ct. 859, 58 L. ed 1276; Lawrence v. State Tax Commission of Mississippi, 286 U. S. 276, 52 S. Ct. 556, 76 L. ed. 1102.

(Footnote continued from preceding page.)

consin commission claimed, intimating thereby that the Wisconsin Commission was contending for a restriction of its power so that it would be compelled to compute the tax of affiliated corporations upon a combined basis; when, as a matter of fact, what the Wisconsin Commission actually claimed was the **discretionary** power to tax affiliated corporations upon a combined basis. Who ever **heard of a governmental commission, in this day and age, ever contending for a restriction rather than for an expansion of its powers?** Therefore, this cannot be considered as adequate and independent non-federal ground.

A large part of the last paragraph dealing with the legislative history of this provision of the Minnesota Act is taken up with an effort to establish the intent of the legislature to give the word "may" in the second sentence of section 32c of the Act, a mandatory rather than its natural permissive interpretation, on the alleged ground this normally would be more profitable to the state (R. pp. 1644, 1645, 207 Minn. 630, 634, 635, 292 N. W. 407, 410).

The utter fallacy of this contention has been definitely established in the State's Petition and Brief (pp. 82-85), on the basis of statistics furnished by the Treasury Department of the United States government. Therefore, this also cannot be considered as an adequate and independent non-federal ground.

The next paragraph is fairly lengthy (R. p. 1645, 207 Minn. 630, 635, 292 N. W. 407, 410). It is devoted to a consideration of the question of penalty. This paragraph forms the basis for the State Court's conclusion that the granting of discretionary power to the Tax Commission in the matter of computing the tax of affiliated corporations upon a combined basis, would be unconstitutional. Therefore, it too cannot be said to provide an

independent and adequate non-federal ground for the opinion of the Court.

Then follows a fairly short paragraph (R. pp. 1645, 1646, 207 Minn. 630, 635, 636, 292 N. E. 407, 410). This returns to a consideration of the intent of the legislature from the revenue standpoint. Having already previously stated that the mandatory taxation of affiliated corporations upon a combined basis would normally be more profitable to the state, the court continues along this vein with the thought that affiliated groups of corporations would seek to avoid all suspicion of tax evasion so as to retain the advantage of being taxed upon an individual basis rather than upon a combined basis. Hence, neither can this paragraph be considered as an independent and adequate non-federal ground for the opinion of the State Court.

The next paragraph refers to the rule of statutory construction when the power conferred is to be exercised for the benefit of the state or a private party. Standing alone, this paragraph would be meaningless because it does not state for whose benefit the power was conferred in the instant case. It only has application in connection with the erroneous theory advanced by the State Court that the mandatory taxation of affiliated corporations upon a combined basis would normally be most profitable to the state. Hence this paragraph likewise offers no independent and adequate ground for the decision of the State Court.

Thus no particular significance can rightfully be attached to the amount of space devoted by the State Court in its opinion to these alleged non-federal grounds for its decision.

The involved reasoning of the State Court in its opinion in the Oliver case can only be explained when there

is taken into consideration the fact that it was seeking to find an **alternative** to a construction of a provision of a statute which would render it unconstitutional. This has been demonstrated in the State's Petition and Brief pp. 79-81, in which were cited the cases of State ex rel Decker v. Montague, 195 Minn. 278, 262 N. W. 684 and Johnson Service Co. v. Kruse, 121 Minn. 28, 140 N. W. 118, also Dunnell's Minnesota Digest, Sections 8931 and 8950.

The State Court undertook the task of finding a "reasonable **alternative**" to a construction of a statutory provision which would render it unconstitutional, even though the construction resulting in unconstitutionality was the **"more natural"**. Thus all the discussion in the State Court's opinion prior to its consideration of the constitutional questions involved is but **preliminary** thereto.

It is of the utmost significance that the **only** place in the entire opinion where the State Court specifically stated in so many words that it is actually interpreting the statute, is in the last sentence of the paragraph discussing the constitutional questions, where the court says (R. pp. 1646, 207 Minn. 630, 636, 292 N. W. 407, 411).

> **"We therefore give the statute an interpretation in harmony with the constitution."** (Emphasis supplied.)

Hence everything that the State Court said in its opinion before is but the **prelude** to the **climax** reached in this sentence where the court performs the **decisive act of interpretation.**

Thus the Minnesota Supreme Court has inextricably interwoven all the federal and non-federal grounds into the fabric of its decision in this case.

As has already been demonstrated in the State's Petition and Brief, the rationale for all the constitutional objections to the natural permissive interpretation of the word "may" in the second sentence of section 32c of the Minnesota Act break down completely when it is once recognized that the granting of discretionary power to tax affiliated corporations upon a combined basis in a proper case does not amount to the granting of the power to impose a discretionary penalty upon the affiliated group.

It has been recognized by a number of states having similar provisions in their statutes, including New York and California, that the granting of such discretionary power to a tax commission makes it easier to cope with the complex tax problems arising from the intercompany transactions of affiliated corporations. Congress has also seen fit to grant the Commissioner of Internal Revenue discretionary powers in this field.

In no case has any other court, either Federal or State, ever construed the exercise of such discretionary power by a taxing authority as the imposition of a penalty upon the affiliated group of corporations thus taxed upon a combined basis.

We submit that when once made aware that the natural permissive interpretation of the word "may" in the contested provision of the Minnesota Act would not make it violative of the Fourteenth Amendment, the State Court would recognize that the rationale by which it had arrived at its decision had broken down. The State Court would then feel free to give the word "may" in this provision of the Minnesota Act its natural permissive interpretation, and not find it necessary to wander far afield in order to justify an unnatural mandatory interpretation thereof.

POINT III.

Relating to the inclusion of income from Federal Securities in the measure of the Minnesota Corporate Franchise Tax.

A. THE QUESTION IS NOT MOOT.

The Question as to the inclusion of income from federal securities in the measure of the Minnesota corporate franchise tax would most certainly **not** be moot, should this Court determine **any one** of the other questions involved in the within cases in favor of the State of Minnesota. A decision upholding the State's contention in reference to income from federal securities would then serve to increase the amount of taxes for the year 1933 which would be due to the State of Minnesota from respondents who would be affected thereby. Hence this question is **not** moot.

The claim that this question is moot can therefore only be raised in the event that this Court should decide against the State on **all** the other questions involved in the within cases. Only then would the State Court's computation of a net deficit for the affiliated group of corporation in excess of $900,000 be permitted to stand. This sum, of course, is greater than the sum of $364,110.24 received by respondents as income from federal securities.

However, this question is one of great public concern to the State of Minnesota. All corporations taxable under the provisions of the Minnesota Act which derive any income at all from federal securities are affected thereby; not merely the respondents. Even the respondents may be affected in their taxation for years subsequent to 1933.

In holding that the inclusion of income from federal securities in the measure of the Minnesota corporate franchise tax is violative of the United States Constitution, the State Court has set a precedent which is seriously hampering the collection of corporate franchise taxes by the State of Minnesota. This makes it of the upmost importance to the State that a determination of this question be had as soon as possible.

If this Court should not consider this question now, it would mean that several years more may have to elapse before this question could finally be determined. In the meantime, the collection of corporate franchise taxes by the State of Minnesota would be seriously interfered with.

There is ample precedent for this Court to take cognizance of this predicament of the State of Minnesota and to consider this question. This court held in Southern Pacific Terminal Co. v. Interstate Commerce Commission, 219 U. S. 498, 31 S. Ct. 279, 55 L. Ed. 310 as stated in the syllabus. [8]

> "The case is **not** moot where **interests of a public character as asserted by the Government under conditions that may be immediately repeated,** merely because the particular order involved has expired." (Emphasis supplied.)

Therefore, in any event, the determination of this question properly lies within the discretion of this Court.

---

[8] See also
United States v. Trans-Missouri Freight Assn., 166 U. S. 290, 17 S. Ct. 540, 41 L. ed. 1007;
Southern Pacific v. Interstate Commerce Commission, 219 U. S. 433, 31 S. Ct. 288, 55 L. Ed. 283;
National Labor Relations Board v. Pennsylvania Greyhound Lines, 303 U. S. 261, 58 S. Ct. 571, 82 L. ed. 831;
Federal Trade Commission v. Goodyear Company, 304 U. S. 257, 58 S. Ct. 863, 82 L. Ed. 1326.

B. THE DECISION OF THE STATE COURT ON THIS QUESTION IS NOT SUPPORTED BY ANY DECISIONS OF THIS COURT.

Under the Minnesota Act, income from federal securities is included together with income from all other securities in the measure of the Minnesota corporate franchise tax, practically the sole exception being income from obligations of the State of Minnesota and its governmental subdivisions.

This is not a case in which income from federal securities has been made the principal target of the tax, as was found by this Court in Miller v. Milwaukee, 272 U. S. 713, 47 S. Ct. 280, 71 L. Ed. 487. Nor is this a case where the tax was striking at the immunity from state taxation of federal securities, by making payment or specific exemption from the payment of another tax under the provisions of a statute in no way applicable to federal securities, the basis for exemption from the measure of the new tax. This was the situation in the opinion of this Court in Schuykill Trust Co. v. Pennsylvania, 296 U. S. 113, 56 S. Ct. 31, 80 L. ed. 91. These are the only cases cited by the State Court in its opinion on this question. Nor do any of the other cases cited in respondent's brief deal with a situation in which income from state obligations is the sole exception to inclusion in the measure of a tax. Hence they are not in point.

This question has been fully presented by the State of Minnesota in its Petition and Brief pp. 85-103, of which the following is a summary:

> "(1) The United States Supreme Court decisions relied upon by the Minnesota court do not support its holding that the inclusion of income from federal securities in the measure of the Minnesota corporate franchise tax constitutes "unfriendly discrim-

ination" against United States securities in favor of local securities in 'substantial competition' with federal securities.

(2) The Minnesota statute Section 12, places income from federal securities in the same class as income from all other securities, in regard to inclusion in the measure of its corporate franchise tax, with the sole exception of Minnesota state and local obligations.

(3) Statutes giving preferment to state over federal securities in the matter of this inclusion in measures of franchise taxation have been construed as valid in other states.

(4) New York State now has a statute in force giving certain of its bonds a much greater preferment in the field of corporate franchise taxation, than would be their mere exclusion from the measure of such a tax.

(5) Laws of this character have not interfered with the marketing of federal securities in the important state of New York or elsewhere in the United States.

(6) Congress itself has enacted legislation resulting in giving a preferment to state securities over federal securities by making federal securities subject to surtax and excess profits taxation by the United States.

(7) The granting of some additional inducement to investors in the way of tax preferment is justifiable in the case of state and local securities since they are less attractive to purchasers than federal securities.

(8) The Minnesota corporate franchise tax statute exempts institutional investors which are the most important class of corporate purchasers of both state and Federal securities.

(9) Minnesota has evidenced no hostile intent against the United States government in excluding its own securities from the measure of its corporate franchise tax.

(10) In the cases now before this Court, there is no evidence whatsoever that the securities of the State of Minnesota and its local subdivisions are in 'substantial competition' with the securities of the federal government."

C. THE MINNESOTA SUPREME COURT COULD NOT HAVE EXCLUDED INCOME FROM FEDERAL SECURITIES FROM THE MEASURE OF THE TAX ON RESPONDENTS ON ANY NON-FEDERAL GROUND.

Respondents contend that the State Court would have been compelled to exclude income from federal securities from the measure of respondent's franchise tax in view of its decisions in the within cases.

In answer we quote from the State Court's decision of April 26, 1940 (R. pp. 1817, 1818, 207 Minn. 637, 640, 292 N. W. 410, 413.

> "It cannot be said that the interest so earned was outside exercise of the franchises for railroad purposes nor that the funds so deposited had become so characterized as an investment to produce interest within the holdings in State v. N. P. Ry. Co., 192 Minn. 473, 167 N. W. 294; and State v. Great Northern Railway Company, 139 Minn. 469, 167 N. W. 298."

In the just cited case of State v. G. N. Ry. Co., the Minnesota Supreme Court said (139 Minn. 469, 471, 167 N. W. 297):

> "In addition to such securities the defendant owns others which the Court held not owned or used for railway purposes within the meaning of the gross earnings statute and therefore subject to an ad valorem tax". * * * It owns bonds of the Northern Land Company which owns the quarries at Sandstone from which it gets traffic. It owns stock in an electric company having a power plant in Washington. It is in prospect that the plant will be developed and the power used in the electrification of the defendant's road. It owns the bonds of a hotel company in Spokane; bonds of an irrigation district in Washington; bonds of a land company; bonds of a city in Washington received in payment for property sold; bonds of the Wisconsin Central Railway Company received in exchange for terminal property, and bonds of the Pillsbury-Washburn Company which it took years ago in payment of freight earned, which the company was unable to pay at the time. The court found that the bonds of the Pillsbury-Washburn Company had been held unreasonably long and had ceased to be working capital and had become an investment.
>
> It is clear that property of the general character indicated, though acquired properly and in the exercise of good business judgment, is not owned or used for railway purposes within the principle of our holdings."

Thus many types of securities and holdings were characterized as investments in the Great Northern

Case, which the State Court has cited in its opinion as setting the rule for what is to be characterized as an investment.

Hence it would hardly be possible for the State Court to rule that federal securities are not also **characterized as investments,** within its holdings in the Great Northern case.

Therefore, income from federal securities would have to be included in the measure of respondent's franchise tax as non-railroad income, if it were not for the federal question involved.

CONCLUSION

For the foregoing reasons this Court should grant the petition for writs of certiorari to review the final judgments of the Supreme Court of the State of Minnesota in the above entitled actions and each of them as prayed for therein.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

No. 539.
STATE OF MINNESOTA, *Petitioner,*
vs.
DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY, AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 540.
STATE OF MINNESOTA, *Petitioner,*
vs.
THE DULUTH AND IRON RANGE RAIL ROAD COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 541.
STATE OF MINNESOTA, *Petitioner,*
vs.
SPIRIT LAKE TRANSFER RAILWAY COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 542.
STATE OF MINNESOTA, *Petitioner,*
vs.
OLIVER IRON MINING COMPANY, *Respondent.*

No. 543.
STATE OF MINNESOTA, *Petitioner,*
vs.
PROCTOR WATER & LIGHT COMPANY, *Respondent.*

BRIEF OPPOSING PETITION FOR WRITS OF CERTIORARI.

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TABLE OF CONTENTS.

AUTHORITIES CITED.

STATUTES AND OTHER WORKS.

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BRIEF OPPOSING PETITION FOR WRITS OF CERTIORARI.

The State claims that four federal questions were involved in the decisions of the Minnesota Supreme Court in the above entitled causes. Questions I and II as presented

by the State actually involve the same point and the State treated them together. We will consider the three questions in the order in which they are discussed by the State, combining the State's points I and II for treatment under our Point I.

POINT I.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT THE SUMS OF $5,808,256.61 AND $1,966,547.58 RECEIVED BY THE DEFENDANT DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY UNDER THE PROVISIONS OF THE "EMERGENCY RAILWAY TRANSPORTATION ACT, 1933" WERE NOT INCOME DERIVED FROM THE EXERCISE OF THE CORPORATE FRANCHISE FOR OTHER THAN RAILROAD PURPOSES DID NOT INVOLVE OR DEPEND UPON A CONSTRUCTION OF THE FEDERAL CONSTITUTION OR STATUTES, AND HENCE DID NOT DENY TO THE STATE RIGHTS UNDER SAID CONSTITUTION OR STATUTES; AND FURTHERMORE THE FEDERAL QUESTION, IF ANY, WAS NOT RAISED IN TIME.

The Minnesota Supreme Court construed the Minnesota Income Tax Act, as applied to corporations, as imposing a tax upon the corporate franchises, as property, and not upon income (R. pp. ~~1647-1648;~~ 1635-1636; 207 Minn. 618, 623, 292 N. W. 401, 404). It further held that

> "• • • railroads may not be subject to the franchise tax imposed by (the Minnesota Income Tax Act) measured by income from railroad ownership or operation because for such *exercise of the franchise* the gross earnings tax is exclusive, but that they are subject thereto insofar as the franchise is exercised, whether *ultra vires* or not, *for other* than railroad purposes." (Italics ours.) (R. pp. ~~1648-1649~~; 1636; 207 Minn. 618, 624, 292 N. W. 401, 404-405.)

The question therefore that the Minnesota Supreme Court had to, and did, decide with respect to these sums was whether they constituted income derived from an exercise of the defendant's corporate franchise for a non-railroad purpose. Put in slightly different language, the decision on this point involved a consideration of a question of fact, i. e., of the existence or non-existence on the part of the defendant with respect to these sums of any activity other than that of a carrier or railway corporation, which clearly in itself is not a federal question.

The Minnesota Supreme Court was concerned with the Transportation Act, 1920, Emergency Transportation Act, 1933, and the case of *Dayton-Goose Creek R. Co. v. United States*, 263 U. S. 456, only in so far as the same threw light upon the character of the defendant's use of its franchise with respect to these sums. This concern involved no construction of the acts, for they show upon their face and without need to resort to construction that they dealt with the defendant only as a "carrier" or railway corporation; and the same is true of the *Dayton-Goose Creek* case.

To test the matter we may assume the correctness of the State's construction of the federal acts referred to and the *Dayton-Goose Creek* decision, i. e., that the "recapture fund" never belonged to the defendant railway company, that it had no title or interest in the railway contingent fund in the hands of the Government, and no right to demand its return, prior to and except under the Emergency Transportation Act, 1933. How could the adoption of such a construction as opposed to some other construction affect the question of the character of the defendant's franchise activities, if any, with respect to these funds, or determine

that those activities were of a non-railroad character? Actually the Minnesota Supreme Court neither adopted nor rejected the State's construction. There is nothing in the Court's opinions essentially at variance therewith. However, the grounds of its decision with respect to these sums are set forth in the opinion of April 26, 1940, where there is first a restatement, for clarification, of the general test to be applied, as follows (R. p. ~~1820~~ 1817; 207 Minn. 637, 639, 292 N. W. 411, 412):

> "To avoid confusion for tax purposes, the distinction should lie between income derived from the exercise of the franchise within the scope of railroad ownership or operation and that from its exercise without such scope."

And later, specifically referring to the item of accretions and interest on the "recapture fund," an item which the Court had not felt it necessary to deal with in its earlier decision, the Court said (R. p. ~~1821~~ 1817; 207 Minn. 637, 639, 292 N. W. 411, 412-413):

> "It is obvious to us that the accretions and interest did not derive from the exercise of the corporate franchises for other than railroad purposes. The companies were compelled by law because they owned or operated railroads to pay part of their railroad earnings into this fund. The accretions and interest ensued as a result. They are necessarily and obviously a result of the exercise of the corporate franchises in the ownership or operation of railroads. To state the situation is to answer the contention. Had it not been for the exercise of the franchise for railroad purposes these funds would not have been accepted or repaid by the government."

Clearly these conclusions would have been reached by the State Court whatever construction might be placed, in the above mentioned respects, upon the federal acts and decision referred to and actually regardless of any question of construction.

That the "recapture funds" were created under a federal act and their character determined by a United States Supreme Court decision and that they were repaid under a federal act is all simply fortuitous. The creation, status and payment to the railroads of such funds might conceivably have been governed by non-federal legislation and non-federal court decisions or by no legislation or court decisions at all. The essential fact is that the payment was made in 1933 to a railroad company *qua* railroad company and because it was such at the time of the payment to the Government. This fact is what the Supreme Court of Minnesota determined and this is enough to demonstrate that these sums were not the result of an exercise of the railroad company's franchise for other than railroad purposes. The determination of this fact obviously involves no federal question.

The defendant paid the Minnesota state gross earnings tax for the years in which the "recapture funds" were originally received by the railroad on the amount of its gross earnings without deduction on account of payments to the Government under the recapture provision (R. pp. 797-800; 801-805) in accordance with the administrative construction of the Minnesota Gross Earnings Tax Law (R. pp. 801-802), a circumstance which accentuates the railroad character of the recapture funds, when originally received, and fortifies the inevitable conclusion that moneys repaid

to the defendant in 1933 did not involve any exercise of the defendant's franchise for a non-railroad purpose.

The State contends that both parties throughout the proceedings claimed and set up, as to these items, rights under the federal statutes. The State, to invoke this Court's jurisdiction, must indeed show that it claimed and set up such a right. The right that the State is claiming and setting up, and has claimed and set up throughout these proceedings, is the right to tax these sums under the Minnesota Income Tax Act, or include them in the measure of the tax. Of course, the most careful perusal or construction of the federal acts can disclose no provisions conferring or denying such a right. Thus it cannot be said that any rights under any federal act were set up or claimed in this litigation. The present case is quite different from *Jones National Bank v. Yates*, 240 U. S. 541, relied upon by the State, because there the liability created by the federal act was the very basis of the suit. On the contrary the present case is similar to such cases as *Allen v. Arguimbaugh*, 198 U. S. 149, and *Illinois v. Economy Power Co.*, 234 U. S. 497, where the federal statutes involved did not confer upon the complaining party any right nor afford a basis for his action or defense, and where this Court held there was no federal question.

The State (petition, pp. 13-14) asserts the defendant in paragraphs 10 and 12 of its answer alleged that the sums represented moneys received by the taxpayer from the United States Government under the provisions of the Emergency Transportation Act, 1933, but that such moneys did not constitute income of the defendant taxable under the Minnesota State Income Tax Act, among other reasons,

because they constituted a gift from the United States Government and/or income earned by the taxpayer in previous years. The State ignores the fact that preceding these paragraphs in paragraph 7, defendant alleged that the tax was invalid as applied to the defendant or its income, for the reason that (R. p. 291):

> "These defendants and their income and property are exempt from any tax under said Chapter 405 for the reason that they and their property, including franchises, are subject to the so-called gross earnings tax * * *."

In defendant's brief in the State Supreme Court the first and chief point urged with respect to these sums was under the caption "III. So-called nonoperating income cannot be taxed or used as a measure of a tax upon the railway franchises or privileges," and we said (Brief p. 60):

> "An examination of the items of 'so-called non-operating revenue' with respect to the defendant Duluth, Missabe and Northern Railway Company will show that none of them arises from business or activities of a nonrailroad character. These items, mentioned specifically by the State, are the principal amount of, accretions to and interest on the so-called recapture funds; * * *."
>
> "* * * The recapture moneys, including the accretions thereto and interest thereon, certainly do not arise out of the use of any nonrailroad property nor from any nonrailroad activity."

There followed in our brief, it is true, an alternative argument headed "IV. Even assuming that the defendants were subject to the Minnesota Income Tax Act, certain sums are not includable in taxing net income, i. e., * * *

(b) The so-called recapture fund, with accretions, repaid to the defendant Duluth, Missabe and Northern Railway Company." (Brief p. 84.)

Even the contentions stated as an alternative position in defendant's answer, paragraphs 10 and 12, and in its brief, Point IV just referred to, and the State's answer thereto, did not involve claiming or setting up a right under the federal statutes in question, and, furthermore, these contentions were not considered or passed upon by the State Supreme Court. As we have seen above, the State court adopted the first and primary contention of the defendant, i. e., that the sums were not the result of an exercise of the franchise of the defendant for other than railroad purposes and hence could not be used as a measure of a tax upon said franchise.

For a further reason, assuming for present purposes only the correctness of the State's position, it is clear there is no federal question involved with respect to these amounts. Section 2 of the Minnesota Income Tax Act, under which the State sought to impose the tax here in question upon the defendants, is as follows:

> "There is hereby imposed on every domestic and foreign corporation an annual tax for the privilege of existing as a corporation or of transacting any local business within this state during any part of its taxable year, measured by its taxable net income for such year, computed in the manner and at the rates hereinafter provided."

The privilege or franchise taxed is either the corporate franchise to exist or that to transact business. The defendant Duluth, Missabe and Northern Railway Company,

a domestic corporation, was created and existed only for railroad purposes and purposes incidental thereto (R. pp. 269-270), i. e., the corporate franchise "to be" was to be a railroad corporation. If, as the State claimed, the payment of these moneys by the Federal Government involves no *exercise* of the defendant's corporate franchise (State's Brief pp. 55, 56, 57-58), it does not follow that there was any exercise of the corporate franchise for *non-railroad* purposes but, on the other hand, it would follow that there was no exercise of any corporate franchise at all in the sense of transacting any business and the only corporate franchise that then would be taxed or taxable would be the corporate franchise "to be" a railroad corporation. Since that corporate franchise to be cannot be taxed under the Minnesota Income Tax Act for the reasons heretofore referred to, and since there would be involved, on the State's theory, no exercise of any corporate franchise to do, clearly the moneys in question could not be used as a measure of a franchise tax at all.

However, the presence or absence of a federal question does not depend upon the correctness or incorrectness of the State Court's interpretation of the Income Tax Act and its definition of the subject matter taxed. So the State does not advance its claim for a writ of certiorari by arguing that there was no exercise at all of the defendant's franchise to do business, this involving, as we have seen, no federal question.

The alleged right under the federal statutes now asserted by the State was in fact asserted for the first time in its Supplement to its Petition for Rehearing (pp. 55 and 76). The petitions were denied and no rehearing granted, and

in its opinion denying the petitions the State court made no reference to, and did not consider or pass upon, the State's claim (R. p. ~~1819~~ 1815; 207 Minn. 637, 292 N. W. 411). Hence the claim is not only without merit but was set up too late. See *St. Louis & San Francisco R. Co. v. Shepherd,* 240 U. S. 240; *American Surety Co. v. Baldwin,* 287 U. S. 156; *McMillen v. Ferrum Mining Co.,* 197 U. S. 343; and *Waters-Pierce Oil Co. v. Texas,* 212 U. S. 112.

POINT II.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT SECTION 32 (c) OF THE MINNESOTA INCOME TAX LAW REQUIRED, INSTEAD OF MERELY PERMITTING, THE COMPUTATION OF THE TAX OF AFFILIATED CORPORATIONS UPON THE COMBINED NET INCOME BASIS, WAS NOT BASED SOLELY OR PRIMARILY UPON CONSTITUTONAL GROUNDS, EITHER STATE OR FEDERAL, BUT UPON ITS CONSTRUCTION OF THE LAW DERIVED FROM (a) A STUDY OF LEGISLATIVE INTENT, AND (b) THE APPLICATION OF GENERAL CANONS OF CONSTRUCTION.

The State admits that the decision of the Minnesota Supreme Court upon the question now considered was based upon non-federal grounds, but argues that these were not adequate or independent grounds, and that the Minnesota Supreme Court was driven to its decision by the fact that if the word "may" were construed as permissive it would result in a violation of the United States Constitution, and that therefore a federal question is presented.

Even a cursory examination of the Minnesota Supreme Court's opinion shows that the State's contention is without foundation. At the very commencement of that opinion (after three short paragraphs stating the nature of the case and the general question presented) the Court said (R. p. ~~1655~~ 1672; 207 Minn. 630, 632, 292 N. W. 407, 408):

> "Decision of the controversy lies *in the proper construction* of subd. (c) of § 32 of c. 405 * * *." (Italics ours.)

Then the bulk (about four and a half pages of the Minnesota reports) of the remaining portion of the opinion is devoted to considering the proper construction of the word

"may" as derived from legislative intent and from ordinary rules of statutory construction. In the course of the consideration of these non-federal grounds for the decision, the Minnesota Supreme Court expressly introduced one part of its discussion with the phrase "Constitutional questions for the present aside" (R. p. ~~1658~~ 1645, 207 Minn. 635, 292 N. W. 410).

It was not until it had dealt fully with the non-federal and non-constitutional grounds of its decision, that the Minnesota Supreme Court took up in one very brief paragraph the constitutional difficulties that would arise if the word "may" were not given a mandatory meaning (R. p. ~~1660~~ 1645, 207 Minn. 636, 292 N. W. 410). Even then they dealt independently with adequate State constitutional objections as well as federal.

The State court reached its conclusion that the word "may" is mandatory independently and in the first instance by several channels, none of them involving constitutional objections, to-wit:

(1) Legislative intent as derived from legislative history (R. pp. ~~1656-1658~~ 1642-1644, 207 Minn. 632, 634, 292 N. W. 409, 410). After a lengthy review of the history of the Wisconsin law, from which the Minnesota section was taken, including court decisions construing the Wisconsin law (*Cliffs etc. Co. v. Tax Commission*, 193 Wis. 295, 214 N. W. 447; *Curtis Co. v. Wisconsin Tax Commission*, 214 Wis. 85, 251 N. W. 497), it arrived at the following conclusion (R. p. ~~1658~~ 1644, 207 Minn. 634, 292 N. W. 410):

> "It seems obvious that with that litigation in mind the Minnesota legislature attached the last sentence of subd. (c) for the purpose of making the powers and duties of the Minnesota tax commission clear; that it

sought to give the Minnesota commission the power the Wisconsin commission claimed."

(2) Legislative intent as derived from the fact that the act would be "obviously fair and * * * under normal conditions would be profitable to the state" if the word "may" was mandatory. The Court said (R. p. ~~1658~~ 1645; 207 Minn. 634, 292 N. W. 410):

"We are convinced that our legislature intended the imposition of a tax upon the affiliated corporations described in the last sentence of § 32 (c) as if they were but one corporation, a provision which is obviously fair and which under normal conditions would be profitable to the state as imposing a higher rate of taxation. It is clear that such a construction of the tax is normally in the interest of the state. Where graduated surtaxes are imposed, any other construction of the act would be unfair to the state as permitting what is actually one taxpayer to be divided into several so that a lower rate would be applicable."

(3) Legislative intent as derived from the fact that subdivisions (a) and (b) of Section 32 provide penalties which the legislature intended for tax evasion by corporations, whereas subdivision (c) of that section was not of a "penalty" character (R. pp. ~~1658-1659~~ 1645-1646). The Court said (R. p. ~~1659~~ 1645; 207 Minn. 635, 292 N. W. 410):

"To us it seems clear that the legislature intended a tax always to be imposed and not a penalty for some undefined evasion."

(4) Legislative intent as disclosed by the fact that by the first sentence of subdivision (c) the Tax Commission is empowered and "we think compelled" to require and

permit consolidated tax statements from affiliated or related corporations for the purpose of determining the taxable income of any one of such corporations. As to this the Minnesota Supreme Court said (R. p. ~~1650~~ 1645-1646; 207 Minn. 635, 292 N. W. 410):

> "By the first sentence of subd. (c) the tax commission is empowered and we think compelled to require and permit consolidated tax statements from affiliated or related corporations for the purpose of determining the taxable income of any one of such corporations, and we think it makes plain common sense and discloses the obvious intent of the legislature to interpret the word 'may' in the last sentence as 'shall' and thus to require the imposition of one income tax upon a group of affiliated corporations where 90 per cent or more of the voting stock is held by one interest."

(5) The application of the general rule of statutory construction that "where a power is conferred to be exercised for the benefit of the state or a private party the word 'may' is to be construed to mean 'must' and the statute is mandatory" (R. p. ~~1660~~ 1646; 207 Minn. 636, 292 N. W. 410).

At the end of the four and one-half pages of discussion the State Supreme Court at this point had conclusively demonstrated upon the grounds of general statutory construction that the word "may" should be construed as mandatory in the context of the act. It was only then that it proceeded at all to consider constitutional objections in the short paragraph immediately following.

The Court held that if the word "may" were construed as permissive, there would be "an unconstitutional dele-

gation of legislative powers," citing a decision by this Court, but without specifying whether the delegation would violate the Federal Constitution or the State Constitution, or both.

The Court further concluded (R. p. ~~1660~~ 1646; 207 Minn. 636, 292 N. W. 411):

> "There would also be a lack of uniformity which would violate our constitutional requirements (Minn. Const. art. 9, § 1, *as well as* U. S. Const. Amend. XIV) if discrimination resulted." (Italics ours.)

The Court here clearly gave as an independent and adequate ground of constitutional objection the violation of the State, as distinguished from the Federal, Constitution.

POINT III.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT SECTION 12 OF THE MINNESOTA STATE INCOME TAX ACT, BECAUSE OF ITS EXCLUSION OF INCOME FROM STATE AND LOCAL SECURITIES, VIOLATES THE IMMUNITY FROM TAXATION OF FEDERAL SECURITIES UNDER THE UNITED STATES CONSTITUTION BY ITS INCLUSION OF INCOME FROM FEDERAL SECURITIES IN THE MEASURE OF THE TAX, DOES NOT AFFORD A GROUND FOR GRANTING A WRIT OF CERTIORARI.

There are three reasons why the decision of the Minnesota Supreme Court holding that income from federal securities could not be included in the measure of the Minnesota Income Tax Act does not afford a ground for granting the writs of certiorari sought by this petition. We will discuss them separately.

A. The question is moot because, even if the income from federal securities were included in the measure of the tax as against the defendants, there would be no tax against the defendants or affiliated companies when computed upon the combined net income basis provided for by Section 32 (c) of the Act.

It is, of course, settled that this Court will not take jurisdiction, even where a federal question is involved on the face of the record, if in fact the question is insubstantial in the sense that its decision could not affect the disposition of the case. Thus this Court will not decide a question which has become moot, *Shaffer v. Howard*, 249 U. S. 200; *Commercial Cable Co. v. Burleson*, 250 U. S. 360, nor one which, in the circumstances, is hypothetical. *City of Cincinnati v. Vester*, 281 U. S. 439, 448; *Abrams v. Van Schaick*, 293 U. S. 188; *Tennessee Publishing Co. v. American Nat.*

Bank, 299 U. S. 18, 22; *Anniston Mfg. Co. v. Davis*, 301 U. S. 337, 355.

Here, assuming that there is a federal question involved and that this Court might reverse the State Court decision with respect to it and hold that there should be included in the measure of the tax income received from federal securities, there would be taxable income chargeable to the two defendants Duluth, Missabe and Northern Railway Company and The Duluth and Iron Range Rail Road Company in the aggregate sum of $364,110.24 (State's petition p. 33).

However, the State Supreme Court said (R. p. ~~1655~~ 1642, 207 Minn. 630, 631; 292 N. W. 408):

> "It so happens in this case that if they (the affiliated corporations) be taxed as one corporation their losses are such that they have no taxes to pay, whereas if they be severally assessed for the taxes in question some of the corporations will be liable for a tax."

And again (R. p. ~~1823~~ 1819; 207 Minn. 637, 642, 292 N. W. 411, 414):

> "As we compute the net deficit from the figures in the state's brief, it is, in view of our holdings as to what is taxable under c. 405, something in excess of $900,000."

As a matter of fact the record shows that not only was the net deficit in excess of $900,000 but greatly in excess thereof. It is to be remembered that the State Supreme Court had held that Section 32 (c) of the Act as construed by the Court *required* the Minnesota Tax Commission to impose the tax as though the combined entire taxable net income of the defendants and their affiliated corporations was that

of one corporation and hence to set off the deficit of one corporation against the income of others.

Thus it is clear that even if the $364,110.24 here involved be included in the measure of the tax it would merely reduce the "net deficit" of the affiliated companies from something in excess of $900,000 to something in excess of $500,000.

It would therefore be an empty gesture for this Court to take jurisdiction of the cases here involved, upon this point, even assuming that there was any substantial federal question involved and even assuming further that this Court might decide it favorably to the State, because such a decision by this Court would not result in the recovery by the State of any tax whatsoever either from the defendants here involved or any of their affiliated companies.

We shall proceed to show, however, that there is no substantial federal question involved.

B. The decision was in accord with the decisions of this Court and hence no substantial federal question was involved.

The granting of a writ of certiorari is not a matter of right but of privilege. One of the reasons that may incline this Court to grant a writ is that a decision of the highest court of the State is not in accord with applicable decisions of this Court. Here, assuming that a federal question was involved, the Minnesota Supreme Court has decided it in accordance with such decisions.

Briefly stated, the State Supreme Court decision on the point here involved held that, interest upon obligations of the State of Minnesota and of its political or governmental subdivisions being excluded from the measure of the tax, income received from the United States could not be in-

cluded, because to do so would in the circumstances violate the immunity from discriminatory taxation enjoyed by the latter income under the Federal Constitution.

Section 12, subsection (f), of the State act expressly excludes the interest from State and local obligations. Subsection (g) of the same section expressly excludes income received from the United States, but subsection (1) by providing that subsection (g) shall not apply to corporations taxable under section 2, i. e., subject to the corporate franchise tax like the defendants in this case, expressly puts back into the measure of the tax such income received from the United States. Of the eleven categories of exemptions provided for in section 12, it is to be noted that only this single class is put back into the measure of such tax.

Although the State Supreme Court in its opinion did not expressly mention subsection (1), the decision which it arrived at with respect to the inclusion of income received from the United States is the only conclusion that could have been reached, and obviously the conclusion that the Court would have reached, had it expressly considered subsection (1) and its effect.

Among the exemptions the State Supreme Court found that the category of interest upon obligations of the State and its political subdivisions was from sources in substantial competition with federal securities (R. pp. 626, ~~1650, 1651~~; 1637-1638 207 Minn. 618, 626, 627, 292 N. W. 406). (Minnesota Tax Commission's Report 1934, p. 126, showing outstanding on December 31, 1932, State and local securities exempt from the tax measure of upwards of $334,000,000.) The Court concluded that this resulted in unlawful discrimination against federal securities under the decisions of this Court, i. e., *Miller v. Milwaukee*, 272 U. S. 713, and *Schuylkill*

1638

Trust Co. v. Pennsylvania, 296 U. S. 113 (R. p. ~~1650~~; 207 Minn. 626, 292 N. W. 406). The Court might also have cited, to the effect that the State cannot impose a discriminatory tax upon income from federal securities nor use the same as a measure of a tax in a discriminatory way, *Helvering v. Mountain Producers Corporation*, 303 U. S. 376, 385; *Helvering v. Gerhardt*, 304 U. S. 405, 413, 420; *Graves v. New York*, 306 U. S. 466, 480, 488; and *Tradesmens National Bank v. Oklahoma Tax Commission*, 309 U. S. 560, 566.

This Court's decisions hold, and of course we do not dispute, that if the tax is a privilege tax measured by income (as is the case here) it is not subject to objection that income from tax-exempt federal securities is included in the measure of the tax, *if* the tax is measured by all income regardless of source and is not discriminatory as against income from federal sources.

In *Pacific Company v. Johnson*, 285 U. S. 480, involving the validity of a California privilege tax upon corporations measured by income including all interest received from federal, state, municipal or other bonds (p. 488), the question was whether the tax could be measured by income "without discrimination as to its source" (p. 490) and this Court, distinguishing the case of *Miller v. Milwaukee*, 272 U. S. 713, pointed out (p. 493) that the Wisconsin Act there involved did more than exhibit the intention of the state sovereignty to include in the dividends taxed those derived from income from an instrumentality of the other

> "*together with income from all other sources.* That admittedly would have been permissible." (Italics ours)

The opinion proceeds (p. 493):

> "Thus, in our dual system of government, action of the one government in the proper exercise of its sovereign powers, regarded as innocuous and permissible notwithstanding its incidental effects on the other, may become offensive and be deemed forbidden if it *discriminates* aganst the other. State taxes which, if *nondiscriminatory,* would be upheld, even though they reach or affect those engaged in interstate commerce, are condemned if they *discriminate* against those so engaged, by placing on them heavier burdens than imposed on others within the state." (Italics ours)

With respect to the California statute the Court concludes (p. 496):

> "As it operates to measure the tax on the corporate franchise by the *entire net income* of the corporation, *without any discrimination* between income which is exempt and that which is not, there is no infringement of any constitutional immunity." (Italics ours)

In *Tradesmens National Bank v. Oklahoma Tax Commission,* 309 U. S. 560 (decided March 25, 1940), involving the validity of a state franchise tax on a national banking association measured by the entire net income including interest upon obligations of the United States, this Court, after referring to authorities, including *Pacific Co. v. Johnson, supra,* and *Miller v. Milwaukee, supra,* said of the State tax act (p. 566):

> "It has effected its purpose by including within the measure of its franchise tax on national banks *the entire net income without respect to source and without discrimination against tax-exempt federal securities.*" (Italics ours)

and the Court then proceeded to hold that the statute merited the tests stated in *Pacific Co. v. Johnson, supra,* quoting the language above quoted from that case.

In *Schuylkill Trust Co. v. Pennsylvania,* 296 U. S. 113, a statute of Pennsylvania imposing a tax upon the capital stock of corporations measured by "so much of the net assets as is not represented by shares of Pennsylvania corporations already taxed or exempt from tax" (p. 117) was attacked as discriminating against United States securities because such securities were not deducted at their full value. The Court held that *if,* under the State law, shares of stock of Pennsylvania corporations or assets declared exempt by State law are taken out of assets in computing the tax, then it is a discrimination against federal securities if such securities are included. This Court speaking through Mr. Justice Roberts, said (p. 120):

> "If the tax is lifted from the shares of certain trust companies because those companies own only stocks already taxed or relieved from taxation by the State, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law *discriminates* in favor of the former and against the latter solely by reason of ownership of such federal securities." (Italics ours)

The decision of the State Court sustaining the tax was reversed. In his dissenting opinion Mr. Justice Cardozo, while finding no forbidden discrimination in the case, recognized that in certain circumstances discrimination would invalidate the tax, saying (p. 129):

> "The discrimination, as has been said, must be so marked as to justify the inference that it was unfriendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities."

Thus the majority opinion held that any discrimination against federal securities was invalid and even the minority took the view that discrimination was unlawful which was either unfriendly in design or in favor of securities in substantial competition with federal securities included in the tax base. In the instant case we have the discrimination condemned by the majority and also a discrimination unfriendly in design and in favor of State securities in substantial competition with federal securities.

While certain recent decisions of this Court tend to limit the immunity from taxation by the respective sovereignties, Federal or State, of the income received by the taxpayer from the other sovereignty, the decisions emphatically lay down the rule that the tax must not be discriminatory.

Thus in *Helvering, Commissioner v. Mountain Producers Corp.*, 303 U. S. 376, this Court, speaking through Mr. Chief Justice Hughes, said (p. 385):

> "We have always recognized that no constitutional implications prohibit *a non-discriminatory* tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency."

In *Helvering, Commissioner v. Gerhardt*, 304 U. S. 405, this Court, speaking through Mr. Justice Stone, referring

to the case of *McCulloch v. Maryland,* 4 Wheat, 316, said (p. 413):

> "It was perhaps enough to have supported the conclusion that the tax was invalid, *that it was aimed specifically at national banks and thus operated to discriminate* against the exercise by the Congress of a national power. *Such discrimination* was later recognized to be in *itself* a sufficient ground for holding invalid any form of state taxation adversely affecting the use or enjoyment of federal instrumentalities. *Miller v. Milwaukee,* 272 U. S. 713; cf. *The Pacific Co., Ltd. v. John-on,* 285 U. S. 480, 493." (Italics ours)

The Court then proceeded to hold valid the imposition of the federal income tax upon the compensation of employees of the Joint Port Authority of the States of New York and New Jersey, saying (p. 420):

> "A *non-discriminatory tax* laid on their net income, *in common with that of all other members of the community,* could by no reasonable probability be considered to preclude the performance of the function which New York and New Jersey have undertaken, or to obstruct it more than like private enterprises are obstructed by our taxing system." (Italics ours)

Mr. Justice Black in his concurring opinion also points out that the tax is a *non-discriminatory* tax upon income from the state.

In *Graves v. New York,* 306 U. S. 466, the question was as to the authority of the State to impose a tax upon the income of an employee of the Home Owners' Loan Corporation. Mr. Justice Stone in the opinion said (p. 480):

> "The present tax is *a non-discriminatory tax* on income applied to salaries at a specified rate." (Italics ours)

The tax was sustained because it was "a non-discriminatory general tax" (p. 487).

Mr. Justice Frankfurter in his concurring opinion said (p. 488):

> "Since two governments have authority within the same territory, neither through its power to tax can be allowed to cripple the operations of the other. *Therefore state and federal governments must avoid exactions which discriminate against each other or obviously interfere with one another's operations.* These were the determining considerations that led the great Chief Justice to strike down the Maryland statute as an unambiguous measure of discrimination against the use by the United States of the Bank of the United States as one of its instruments of government." (Italics ours)

As we have seen, the Minnesota Income Tax Act excludes from the measure of the tax a large number of items of income, among them interest upon State and municipal bonds. So long as the State measures the tax by income without regard to the source, it may include income from federal securities in the measure of the tax. That is as far as the State has the power to go in including income from that source in the measure of the tax. Otherwise the tax is subject to the constitutional objection that it violates the provisions of the Fourteenth Amendment to the Constitution of the United States, particularly in that it denies the equal protection of the laws and because it invades the immunity from discriminatory taxation of activities of the Federal Government.

The decision of the Minnesota Supreme Court was not only in accordance with, but the necessary result of, the

decisions of this Court just cited, and hence no meritorious federal question is here presented by the petitioner.

C. The Minnesota Supreme Court could and clearly would have excluded the income from federal securities here in question from the measure of the tax on a non-federal ground, i. e., that the same did not result from the exercise of the corporate franchise for a non-railroad purpose, if it had not considered the inclusion of the sums discriminatory.

Respondents recognize that the mere fact that the State Court *could* have reached the same conclusion upon an independent non-federal ground would not be sufficient to justify this Court in refusing to take jurisdiction provided that a meritorious federal question were involved. However, when upon the very face of the decisions of which petitioner seeks review it appears, as here, that the State Supreme Court not only could, but inevitably would, reach the same conclusion, i. e., that the income in question could not be included in the measure of any tax upon the franchises of the defendants, upon an independent and adequate non-federal ground, it is a circumstance which this Court will wish to take into consideration in determining whether it should grant the writ sought, that being a matter of privilege and not of right.

An examination of the Supreme Court opinions discloses that with respect to substantial sums on deposit with the United States Steel Corporation, the State Court held that interest thereon was railroad income and hence could not be included in the measure of the tax. The same was true of all other items of so-called "non-operating" income considered including interest on bank deposits, working capi-

tal, income from houses rented and sold to employees, etc. (R. pp. ~~1821-1822~~ 1817-1818; 207 Minn. 637, 640; 292 N. W. 411, 413).

In the same category were the federal securities. It appears without dispute (R. pp. 908-909, 910, 912, 921) that in the case of the Duluth, Missabe and Northern Railway Company a substantial part of the income from federal securities was derived from United States bonds held as a part of the so-called Railroad Transportation Fund by the defendant, as a carrier, under the provisions of the Transportation Act of 1920 and that all of the said federal securities were held by the defendant for railroad purposes just like the other portions of the funds expressly passed on by the Court, mentioned in the preceding paragraph. Furthermore, the record shows (p. 921) that the defendant Duluth, Missabe and Northern Railway Company was engaged solely in railroad activities.

It appears without dispute (R. p. 968) that in the case of The Duluth and Iron Range Rail Road Company all of the federal securities from which the income in question was derived were held for railroad purposes.

There is no evidence, no findings of fact and no suggestion in the opinions of either the trial Court or the Minnesota State Supreme Court that either of the defendant railways was engaged in non-railroad activities of any kind.

The State Supreme Court having held that income from other portions of this same fund was not derived by the defendants from the exercise of their franchises for non-railroad purposes and the evidence being uncontradicted that the interest here in question was of the same category,

the State Court would inevitably hold that these items of interest on federal securities were likewise from a non-railroad activity.

CONCLUSION.

For the foregoing reasons this Court should deny the petition for writs of certiorari to review the final judgments of the Supreme Court of the State of Minnesota in the above entitled actions and each of them.

Respectfully submitted,

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November 20, 1940.